

# PACKERS AND STOCKYARD ISSUES

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## HEARING BEFORE THE COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY UNITED STATES SENATE

ONE HUNDRED SEVENTH CONGRESS  
SECOND SESSION

—————  
JULY 16, 2002  
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Printed for the use of the  
Committee on Agriculture, Nutrition, and Forestry



Available via the World Wide Web: <http://www.agriculture.senate.gov>

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U.S. GOVERNMENT PRINTING OFFICE

86-214 PDF

WASHINGTON : 2003

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## **PACKERS AND STOCKYARDS ISSUES**

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**TUESDAY, JULY 16, 2002**

U.S. SENATE,  
COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY,  
*Washington, DC.*

The Committee met, pursuant to notice, at 10:07 a.m., in room SD-562, Dirksen Senate Office Building, Hon. Tom Harkin, [Chairman of the Committee], presiding.

Present or Submitting a Statement: Senators Harkin, Conrad, Daschle, Lincoln, Nelson, Dayton, Wellstone, Lugar, Roberts, and Thomas.

### **STATEMENT OF HON. TOM HARKIN, A U.S. SENATOR FROM IOWA, CHAIRMAN, COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY**

The CHAIRMAN. The Committee on Agriculture, Nutrition, and Forestry will come to order.

This committee has previously given a good deal of attention to economic concentration and the competitiveness of livestock markets. We debated the issues and took some action in the new Farm bill, but today we will further examine packer ownership of livestock and the USDA enforcement of the Packers and Stockyards Act because we still have a long way to go in restoring fairness, openness, and confidence in these markets.

Because of widespread consolidation and vertical integration, packers are in a much stronger position to exert economic power to manipulate livestock and meat supplies in markets. Producers and consumers alike have a critical stake in this trend. The news has been filled lately with reports of how market manipulation and unfair practices have damaged consumers, market participants, and our overall economy. That is just as true for livestock and meat markets as it is for energy and stock markets. Simply put, a ban on packer ownership of livestock would limit the ability of packers to dominate and manipulate markets by locking up supplies.

We tried to do this in the Farm bill. We passed it in the Senate, first by a vote of 51 and then by a vote of 53. When we got to conference, the House refused to accept it, and the administration refused to take a position on the issue. Clearly, if the ban on packer ownership is ever to be enacted, greater understanding and support for it will be essential. In today's hearing, we will hear from farmers, ranchers, and others in the livestock and meat industry. I hope today we will get a clear statement of the administration's position on this issue.

Obviously, it is still a controversial topic. For those who oppose the ban and predict negative consequences if it is adopted, I would simply point to the record in my own State of Iowa. Iowa law has prohibited packers from owning livestock for over 20 years, and we are still the number-one producer of hogs in the Nation, with a strong independent hog farming sector and more hog packing plants than any other State.

Also, given the structural changes in the livestock and meat industry, effective enforcement of the Packers and Stockyards Act is more crucial now than at any time in history. We are going to be examining that also today in our hearings.

Again, I look forward to today's testimony, to working with producers, my colleagues, and the USDA to address these critically important issues in the livestock industry.

With that, I would recognize our distinguished ranking member, Senator Lugar.

**STATEMENT OF HON. RICHARD G. LUGAR, A U.S. SENATOR  
FROM INDIANA, RANKING MEMBER, COMMITTEE ON  
AGRICULTURE, NUTRITION AND FORESTRY**

Senator LUGAR. Thank you very much, Mr. Chairman. As you pointed out, today's hearing provides the Agriculture Committee another opportunity to once again visit issues surrounding competition and concentration in American agriculture. Through hearings and legislative achievements, such as mandatory price reporting, this committee has worked in a bipartisan way in recent years to ensure that farmers and consumers benefit from increased transparency and accountability on the part of our Nation's agribusiness sector would be realized.

During the Clinton administration, Chairman Harkin and I introduced legislation to establish the position of special counsel for agriculture in the Justice Department to assist in oversight of merger and acquisition activity related to agricultural business. Shortly after introduction of our legislation, Attorney General Reno proceeded to establish the position and appointed Douglas Ross as the special assistant, who continues to serve in that capacity and is presently involved in several merger investigations related to agriculture.

During the Farm bill debate, there was extensive dialog on a proposed ban on packer ownership of livestock, which we will review again today. Many agricultural business officials contend a packer ownership ban would negatively impact their ability to profitably meet consumer demands that are increasingly diverse and of higher value. Concerned with the increasing consolidation of the livestock industry, many farmers and ranchers believe implementing a packer ownership ban will serve to lessen the pace of concentration.

While today's hearing will also provide opportunity to review the work of the Grain Inspection Packers and Stockyards Administration, GIPSA, it is very important the committee understand the role of GIPSA compared to that of the Department of Justice, as well as the Federal Trade Commission, on matters related to mergers and competition issues in agriculture.

I look forward to the testimony of our panels of distinguished witnesses, and I thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Lugar.  
Senator Wellstone.

**STATEMENT OF HON. PAUL WELLSTONE, A U.S. SENATOR  
FROM MINNESOTA**

Senator WELLSTONE. Thank you, Mr. Chairman. I have a full statement of the record. I know we want to move along.

The CHAIRMAN. Without objection.

Senator WELLSTONE. Let me thank Nolan Jungclaus, who is here today from Minnesota. He is a grain and livestock farmer from Lake Lillian, central Minnesota. Raises 450 acres of crops and also has a small farrow-to-finish hog operation, which raises over 600 head per year of antibiotic-free pork.

He is a board member of Prairie Farmers Cooperative, which I visited, a locally owned and operated hog processing facility. I want to welcome Nolan. I want to thank Farmers Union and Land Stewardship Project for all their support.

It is interesting, Mr. Chairman, the Farm Bureau as well, all coming in. What I find at every meeting I am at in greater Minnesota in farm country is there is a tremendous amount of support for this legislation. I would thank Senator Johnson for his very important leadership. It has, for me, been a labor of love doing this with Senator Johnson and Senator Grassley from Iowa as well. Of course, the chairman, Senator Harkin, has absolutely taken the lead on it.

I asked Nolan whether I could summarize his testimony. He does it with a lot of eloquence in terms of what the impact is on communities when your independent producers are driven out, muscled out. I will let him speak to that. All I would say is I think what he is saying today and what our independent producers, livestock producers are saying in Minnesota and around the country is, "We want a level playing field." I mean, "We want a fair shake. We are tired of these packers practicing their own form of supply management and basically muscling us out." They buy when the prices are low, and they sell when the prices are low. Everybody has figured out what they are doing.

I will tell you, if you look at the meat processing industry alone, the four top processing firms for beef, pork, and chickens control between 55 percent and 87 percent of the U.S. market. Now, back when I was a student taking economics classes—101 or 001 or 010, or whatever they were called—I learned that that is at best oligopoly, at worst monopoly. We have almost a cartel situation.

This passed the Senate. I am sorry it was taken out of conference committee. I know you fought very hard for it, Mr. Chairman. I will tell you something, the pressure is building, and we are not giving up. This hearing is extremely important, and we are going to pass this legislation.

I thank you for the hearing.

The CHAIRMAN. Thank you, Senator Wellstone.  
Senator Craig.

**STATEMENT OF HON. CRAIG THOMAS, A U.S. SENATOR FROM  
WYOMING**

Senator CRAIG. Thank you, Mr. Chairman.

I, too, appreciate the opportunity for us to have this hearing. This was hotly debated during the Farm bill, of course. I was one of the sponsors and was pleased to get it through here, so I appreciate your commitment to continue to look at it.

In my opinion, a ban on packer ownership would make tremendous strides increasing market competition, and that is basically what we are for. I don't know that we know the magic answer. I believe additional regulations here are necessary. The Packers and Stockyards Act does not clearly define and address this issue. Usually, I am one who does not want to interfere in the business and have additional government regulations. In the case of these markets, I believe the competitive market has nearly disappeared.

We need to move forward, and I will just cut my comments short. We do find, of course, that we have control, 80 percent of it, just by a few operators here. Producers are price takers in the marketplace. Captive supply is a growing problem. We see an increasing difference between the price to producers and the price to consumers. There needs to be something done about this.

I look forward to the committee today, and we will keep forward on this issue.

The CHAIRMAN. Thank you very much, Senator Thomas. I know how hard you have worked on this issue also, back in the committee and on the floor. I appreciate that very much.

Senator Nelson.

**STATEMENT OF BEN NELSON, A U.S. SENATOR FROM  
NEBRASKA**

Senator NELSON. Thank you, Mr. Chairman. I want to thank all the witnesses for coming to discuss this proposed ban on meat packer ownership and to say also that I wish this was the only challenge that was facing the cattlemen in Nebraska and many other States today, where we are experiencing severe drought conditions. When you combine the concerns about competitive and open markets versus captive supply, together with droughts and the stark reality of beginning to reduce the herds by selling off your stock, it is not a strong commitment toward livelihood in our State.

As we all follow what has been happening, there is a major concern about price manipulation, whether it is manipulation intentional or just because of the size of the captive supply. Faced with the prospect of having to sell the herds, farmers are angry today that the playing field just simply isn't level. That is their concern. Given the tough times, they feel that it is all the more important that something be done to institute equity in the markets so that the field is leveled out.

Finding ways to secure these kinds of markets has to be our goal here today. Securing fair markets also means securing sustainable markets and understanding how changes to them may actually depress prices and hurt the global competitiveness of the U.S. beef and pork industry. Therefore, we must proceed very carefully,

keeping in mind both issues of fairness and market stability as we seek to address the needs of our animal producers.

It is my hope, Mr. Chairman, and, too, it is my pleasure to join together in welcoming our colleagues, Senators Craig and Johnson, and hope that they will be able to help enlighten us as we pursue this very important project of finding a way to balance and open markets with some supply to stabilize the market and stabilize the industry.

Thank you very much.

The CHAIRMAN. Thank you very much, Senator Nelson.  
Senator Conrad.

Senator LUGAR. Mr. Chairman, I ask that a statement by Senator Roberts be made a part of the record.

The CHAIRMAN. Without objection, it will be made part of the record.

[The prepared statement of Senator Roberts can be found in the appendix on page 60.]

The CHAIRMAN. Senator Conrad.

**STATEMENT OF HON. KENT CONRAD, A U.S. SENATOR FROM  
NORTH DAKOTA**

Senator CONRAD. Thank you, Mr. Chairman. First of all, I want to thank the chairman for holding this hearing today, and I want to thank him for his advocacy throughout the battle on the Farm bill.

The Senator from Iowa was absolutely steadfast, both in the consideration of the Farm bill in the committee and passage on the floor of the Senate and in the deliberations of the conference committee. I know because I was there. I just want to thank the chairman for the strength of his commitment and the persuasive, I thought, nature of the presentations made throughout the conference committee.

We faced a very difficult circumstance, where the House was under markedly different orders from what had been the instruction of our Senate colleagues with respect to a position. One of the key reasons for that difference was the position of Senator Johnson. Senator Johnson, who has made this a key issue and a key consideration, both in the committee and on the floor, urged us at every turn to try to prevail in the conference committee.

I would say to Senator Johnson I regret we were not able to be more successful. We did make some significant strides with respect to other issues that were important to our producers, but we were not able to prevail on this one because the House conferees were absolutely dead set against it.

Everywhere I go in my State, farmers and ranchers are saying to me, "Look, something has to be done." We now have an indication from University of Missouri economist Dr. Glenn Grimes that 83 percent of hogs were committed to packers through ownership or contract arrangements—83 percent. We now know that concentration in the beef processing part of the industry has 81 percent of the beef slaughter being accounted for by just four firms.

In 1980, by comparison, the level was just 36 percent. What is happening here is very rapid concentration. I do not fault those companies that are concentrated. I fault the lack of reaction by

Congress and the administration because there are real-world implications as a result of this concentration. It seems to me we have to respond. I believe the legislative proposal before us is one way to do that. It is not the only way, but it is one way, and it is a step that we should take.

I again want to thank the chairman. I want to thank colleagues who have been active in this fight, especially Senator Johnson and Senator Craig.

The CHAIRMAN. I thank the Senator from North Dakota, and I just reciprocate by saying that I remember that day in conference. We debated this issue a half a day. The Senator from North Dakota and I sat there and debated the House on this issue of packer concentration. It was about 3 hours or more that we debated it. We voted it on our side, and we had the votes. We sent it to the House side. Under the rules of conference, only the House can ask for a vote on the House side, and they never asked for a vote. They refused to take a vote on it. The administration refused to take a position on it. We asked them repeatedly, and they would not take a position on it. That is just what happened. I thank the Senator from North Dakota for hanging in there during that long debate, and I think any casual observer would have to conclude that the debate was won on the merits. Something happened on the House side, and they wouldn't take a vote on it.

With that, we thank the two Senators for being here, and I would recognize them. Obviously, your statements will be made a part of the record in their entirety, and I would ask you to summarize them, please, and first to recognize the Honorable Tim Johnson, Senator from South Dakota.

**STATEMENT OF HON. TIM JOHNSON, A U.S. SENATOR FROM  
SOUTH DAKOTA**

Senator JOHNSON. Well, thank you Mr. Chairman. Thank you, members of the Senate Ag Committee, for conducting today's hearing on packer and stockyards issues, including my legislation to ban packer ownership of livestock. I want to thank you for the extraordinary effort that the conference committee members made during the Farm bill debate on behalf of this.

We were not successful, as the chairman has noted. Thanks to your effort and the effort of my colleague, Senator Daschle, we were able to hold on to a version of my country of origin labeling. Senator Wellstone played a key role in that as well, of course, and the Senate Ag Committee. We will be watching the implementation of that as time goes on.

The objective of what is commonly referred to as the Johnson amendment is to restore choice and market access to livestock markets. I believe that America's free enterprise system only works if we have more competition and not less. This bill strengthens the Packers and Stockyards Act, which is an 80-year-old law, by prohibiting meat packers from owning livestock for more than 14 days prior to slaughter. Packers are already prohibited from owning sale barns and auction markets. There is nothing unprecedented about restrictions on what the packers may own or may not own in order to create a competitive environment for livestock production.

My bill exempts producer-owned co-ops from the ban, in addition to packing plants that kill less than 2 percent of the national annual slaughter of beef cattle, which is 724,000 head; hogs, which would be 1.9 million head; or sheep at 69,200.

A ban on packer ownership of livestock will not drive packers out of business. Most of their earnings are generated from branded products and companies marketing directly to consumers. However, packer ownership of livestock could drive independent producers out of business. Under current market conditions, producers are at the mercy of these large corporations. As you know, the Organization for Competitive Markets, the American Farm Bureau Federation, the National Farmers Union, R-CALF USA, and every single farm organization in my State of South Dakota supports legislation to ban packer ownership.

Additionally, over 120 cattle feeders in Texas, Nebraska, Colorado, Kansas, New Mexico, and Oklahoma wrote the Farm bill conference seeking support for the Johnson amendment. Thanks to your leadership, Chairman Harkin, we were able to pass the packer ban twice during consideration of the Farm bill in the Senate. Unfortunately, it was killed, as you noted, by House conferees while the Farm bill was pending in conference committee.

During Senate debate of the Farm bill, I was disappointed that some were fooled, I believe, by influential packers who made claims that our amendment did not clarify whether forward contracts could be used as a marketing tool. Forward contracts have never been prohibited by this legislation. There are some who would prefer that it did. We chose a very narrow restriction on packer ownership, and there has never been a prohibition in our legislation to forward contracting.

However, when packers needed to rationalize their opposition, some twisted the truth, claiming that our legislation would prohibit all forward contracting. As a result of these scare tactics, an effort was made to dilute the amendment into a study. I worked with Chairman Harkin, Senator Grassley, and others to offer language in February to clarify without question that forward contracts were permitted under our amendment. On a vote of 53-46, our packer ownership ban remained in the Senate Farm bill.

Once in conference, Chairman Harkin and I developed a number of compromise alternatives to the packer ban for the House to consider. First, we discussed allowing packers up to 4 years to divest of their livestock, rather than the 18 months. That offer was rejected. Second, we discussed a creative approach to require packers to procure up to 25 percent of their daily slaughter needs from the cash market. This was Chairman Harkin's idea and something being floated now by Senator Grassley. When we asked the House if they would consider this approach, they flatly rejected that as well.

Finally, we even suggested grandfathering existing packer ownership levels and making our legislation prospective rather than retroactive. Like a broken record, the House negotiators again rejected that compromise offer. Despite these and other options that we proposed as compromises, House members of the Farm bill conference committee completely eliminated our packer ban provision

from the final Farm bill by refusing even to vote on the issue. Evidently, they were under heavy pressure. I don't doubt that.

I want to encourage the committee to listen intently to Mr. Herman Schumacher of Herreid, South Dakota, who is representing R-CALF at today's hearing on a later panel. He agrees with me that if competition is not restored to cattle and hog markets, livestock producers in the U.S. will become low-wage employees on their own land, working for packing firms, bearing all the economic risk but none of the potential gain of raising livestock.

Simply put, Herman's testimony underscores the fact that cattle and hog producers do not want to become like the poultry industry. According to USDA, packer concentration has increased 45 percent in the last 20 years. During this time, the packing industry has aligned with the food and retailing conglomerates to acquire profits at triple the rate of inflation. As a result, we have a meat food industry which is doing well at the expense of our farmers and ranchers.

Consider the state of the U.S. cattle and beef market today. One, retail beef prices are at all-time highs, so retailers are making money. Two, demand for beef remains very strong. Consumers want to eat beef. Third, U.S. cattle herd size has fallen to its lowest level in 40 years. Supply and demand economics would suggest that that ought to be good news for cattle prices. Fourth, live cattle prices are abnormally low, with cattle producers sometimes losing as much as \$250 per head for cattle from just a year ago.

These factors spell disaster for free enterprise markets, competition, and the fate of independent livestock producers, particularly, as Senator Nelson has noted, if you add the problems of drought and the stress that that is causing on top of all the other competitive issues. The end consequence is catastrophic.

Four experts who are independent and have not received any financial support from major meat packing firms conducted an analysis that supports my packer ban legislation: John Connor of Purdue, Peter Carstensen of the Wisconsin School of Law, Roger McEowen of Kansas State, and Neil Harl of Iowa State. Their report indicates that hog and cattle markets have three buyers at best and one at worst in any geographic area. If a packing plant shuts down or a packer pulls out of the market for other reasons, prices collapse.

In 2001, 83 percent of hogs were committed to packers by ownership or contract arrangements. That leaves only 17 percent of hogs in the cash market, according to their analysis. In January, USDA revealed that 32 percent of the annual cattle slaughter was committed to packers through ownership or contract arrangements. Twenty-five percent of that captive supply number, 8 percent of the annual slaughter, was packer owned. Twenty-five percent of that amount packer owned.

Without a ban of packer ownership, these percentages will simply increase while competition will disappear altogether. USDA has failed to hire the attorneys to lead investigations on competition cases despite the fact that Congress appropriated increased money for this purpose just last year. Even when USDA has believed that certain packer practices are illegal, their litigators have not won a major competition case for two decades. This means the current

competition law is antiquated and insufficient to deal with modern-day market problems.

In closing, let me just note that on July 3rd, Senator Daschle and I met with more than 700 producers in three South Dakota communities to discuss both the drought and inequities in livestock markets. We asked court reporters to transcribe their discussion at our three meetings, and, Mr. Chairman, I would like to submit their testimony from the court report record for the Senate committee record today.

The CHAIRMAN. Without objection, we will receive that.

Senator JOHNSON. Some ranchers in South Dakota have had complete dispersions of their cattle herds, others losing up to \$250 per head. While in Fort Pierre, I was handed a list four pages long of livestock producers who now have sold off every animal they own. They are out. One rancher experienced \$100,000 loss from a year ago for selling his calves prematurely. No individual or business can survive under these unfair circumstances.

A ban on packer ownership could help restore competition, access, and bargaining power to cattle markets for these ranchers. The issue goes to the very heart of what agriculture will look like in the future. Is it going to be controlled by a handful of powerful firms where farmers and ranchers are, in fact, de facto low-wage employees, bearing all the risk but none of the gain in the market, with no ability to leverage a decent price for their animals? Or will it be a future with a strong patchwork of independent family farmers and ranchers managing their own operations, contributing to rural communities that are diverse and economically strong?

I suggest Congress and USDA take the following two actions to forestall the trend of major meat packers taking over production of livestock in the U.S.:

One, pass this legislation to ban packer ownership of livestock. This time, we need to move the legislation through the House of Representatives as well.

Two, hold a joint hearing of the Senate Judiciary and Ag Committees to further examine the roles the Departments of Justice and Agriculture can do together to play in preventing meat packer mergers that lead to anti-competitive behavior.

I want to thank you, Mr. Chairman and members of this panel, for your leadership and for holding this very timely and critically urgent hearing today. Thank you.

The CHAIRMAN. Senator Johnson, thank you very much for your testimony and thank you for your outstanding leadership on this issue. Safe to say that you have been the point person on this for a long time, and I appreciate your leadership on that.

[The prepared statement of Senator Johnson can be found in the appendix on page 64.]

The CHAIRMAN. Our colleague from Idaho, Senator Craig. Again, your statement will be a part of the record. Please proceed as you so desire.

**STATEMENT OF HON. LARRY CRAIG, A U.S. SENATOR FROM  
IDAHO**

Senator CRAIG. Thank you very much, Mr. Chairman. I will not stay to the text of my full statement, but thank you for adding it to the record.

Senator Johnson and I have partnered on a variety of issues over the years from country of origin labeling to, at one point, the issue of ban of packer ownership. I departed from that company on the floor of the Senate and chose to oppose it because I did believe, and I do believe, that the legislation that was before us at that time created as many problems as it might provide solutions.

I must tell you today, Mr. Chairman, I do believe, as all of you have stated and believe, that we have a concentration in the cattle market and the livestock market today that is damaging producers at an unprecedented rate, and it must be resolved. I am not quite sure that all of us have the solution to that resolution yet. I would suggest we seek it and we seek it in a responsible and bipartisan way and, in so doing, sustain a livestock cattle industry that is key to most of our States and our States' agricultural economies.

I grew up in the cattle business. My dad and I took lots of cattle to the local sale ring. It doesn't exist anymore. We had buyers who came to our ranch to buy our feeder cattle. They don't come anymore, largely because the cash market is nonexistent today. There is no true indicator in the marketplace as to what the value of the product is worth at the producer or at the farm gate level.

Why has that happened? In large part, the concentration that Senator Johnson spoke to and that all of you have spoken to is a product of large packers putting together small numbers of cattle to control a market environment. When I say "small numbers of cattle," we think of the large cattle ranches of the West and of the Dakotas. They are, in reality, a minority of production in this country, and we know that.

Eighty percent of the livestock cattle in this country are produced in herds of 40 head or less. Now, you and I both know that you don't make money on 40 head. What are you doing? You are hobby farming. You have a job somewhere else. You love the ranching environment. You like wearing boots and Levi's and riding a horse because it may have been part of your background or your culture before, but you can't make a living at it. You raise a few cattle.

Astute cattle buyers have concentrated that 80 percent. They own it through their packer relationships, or the packers themselves own it. In so doing so, in my opinion, larger producers they have simply written off. They don't need to go after their cattle today because they control the pricing of the system. When you control 80 percent of the market and if you look at what has happened to the cash market over the last decade, it in large part has disappeared. What is the value of an animal?

Well, it is in the eye, in this case, not of the producer, but the taker. That is part of our problem, and I think we have to address that. At the same time, I don't believe that you, by action of legislation, demand a total recapitalization of a market and an industry environment overnight. It has to come with other efforts to create

flexibility in the marketplace and flexibility in the competition as it relates to packing.

You are still going to get concentration, simply because of the character of world markets today, whether it be in packing or whether it be large livestock operations, large feeding operations, and all of those kinds of things. We have seen it in our State. Small ranchers tend to get smaller or go out of business. Large ranchers would like to get larger, but now they are going out of business simply because the profitability is nonexistent. Senator Johnson has put it very clearly.

At a time when producers ought to be making money, at a time when the cycle of the industry ought to be on the side of the producer, it simply is not. I believe that if a thorough investigation were held today, there is evidence that prices have been controlled and, in fact, in my opinion, manipulated by large packers. They can do so simply by the character of the volume of livestock they own or control, and they also do so knowing that they don't have to worry about the 20 percent that have historically and still today represent the larger producers in the overall makeup of the cattle industry.

We have seen the vertical integration of hogs and poultry. In many instances, it has worked, and it has worked somewhat successfully. That has been an effort. There has been an effort to try that in the livestock or the cattle industry. I don't think it will work. I don't think it will work in a way that some large producers or some large packers believe it would.

At the same time, I would also suggest that we look at a variety of other instruments, and some of those have been proposed, Mr. Chairman. That is to create loans and a variety of other kinds of things and tax credits for those that might want to create new niche markets and new packing entities, and to do so and identify with certain producers that would like to produce a certain type of cattle under certain conditions to create unique markets. Those kinds of things do create flexibility in the marketplace that does not exist.

The large packers, while at the same time they may create labeling in the marketplace, usually don't create terribly unique products for that market. They are interested in volume and in supplying that market in the character in which they supply it.

I am not suggesting you tear down what we have. I don't think that would be an appropriate thing to do. I do believe that we have a problem that demands that it be fixed and that we have to be a part of that. Simply by entering the marketplace and determining how the market will flow is not necessarily a solution.

My father and I almost lost our business once because government entered the marketplace and determined it would try to shape the pricing mechanisms of the market. That does not work. To create true competition in the market, and if we can cautiously and carefully do that, may work.

I was one that did propose a study, and I meant it sincerely. I know that the character of Congress, as you do, is when you can't find an answer to a problem, you study it for a while. Some say this had been studied. If you really brought all of the forces together today in the crisis that we are involved in, with the large

packing industry that we have today, knowing that if we fail to find the right answers the Congress might act unilaterally, that probably solutions would be found for this market and for the producer and the packer themselves.

I am one who believes that this is a problem that cries out for a solution because I, like all of us, watch in our States very viable producers who have survived time and time again the economic crisis of the livestock industry today in true jeopardy. I have held a variety of meetings across my State and listened, and there is anger and frustration because they watch their equities disappear at a time when there should be some margin of profit. They see the very large profits of the packing industry and know that it is not translating effectively because of the character of the market that has been created.

I hope that we can find a solution. I am not going to suggest that the 14-day approach is the way to do it or to require that a certain percentage of livestock be bought in the market. I do know that one of the factors that has to be out there in the end is the re-establishment of a cash market and competitiveness in that market, or we will continue to drive from the industry the larger producer. The small herd producer will be, by the very character of what they do, victims of the packer, and of course, they will find their livelihood somewhere else as they continue to hobby ranch for simply the lifestyle of it.

Thank you very much.

The CHAIRMAN. Senator Craig, thank you very much for a very well-reasoned and straightforward statement on this. I look forward to working with you, as well as Senator Johnson, to try to find those answers and exactly which way we ought to be going. I know you all have busy schedules, and we thank you for being here. Unless somebody has some real questions for the Senators, thank you very much for being here, Larry and Tim.

The CHAIRMAN. Next, we will call our first panel, Mr. William Hawks, Under Secretary for Marketing and Regulatory Affairs, the U.S. Department of Agriculture, accompanied by Donna Reifschneider, the Grain Inspection and Packers and Stockyards Act Administrator.

Again, Mr. Hawks and Ms. Reifschneider—I guess, Mr. Hawks, you will be testifying. Your statement will be made a part of the record in its entirety. If you could, within 5 minutes, summarize your testimony for us, and I would certainly appreciate that.

**STATEMENT OF BILL HAWKS, UNDER SECRETARY FOR  
MARKETING AND REGULATORY AFFAIRS, UNITED STATES  
DEPARTMENT OF AGRICULTURE,**

**ACCOMPANIED BY DONNA REIFSCHNEIDER, GIPSA  
ADMINISTRATOR**

Mr. HAWKS. Thank you, Mr. Chairman, members of the committee. It is certainly a pleasure to be here with you today. I am Bill Hawks, and I am currently serving as Under Secretary for Marketing and Regulatory Programs at the United States Department of Agriculture.

Much more than that, before coming here a little over a year ago, I was a farmer until I had to divest my interest in my farming op-

eration to serve in this capacity. I have grown corn, wheat, soybeans. I have had cattle. I grew up on a dairy farm. I certainly understand the issues that we are dealing with here today.

As you know, GIPSA is divided into two parts: the Federal Grain Inspection Service and the Packers and Stockyards Programs. The Federal Grain Inspection Service establishes Federal grain standards and oversees the official inspection of U.S. grain. Packers and Stockyards Programs administers the Packers and Stockyards Act of 1921, which prohibits unfair, deceptive, and fraudulent practices in the industry. I am committed to ensuring that producers are promptly paid and that livestock marketing firms, meat packers, poultry integrators, and meat distributors face appropriate consequences if they engage in unfair market behavior.

Packers and Stockyards Programs monitors the livestock, meat packing, and poultry industries estimated by the Department of Commerce to have an annual wholesale value of \$125 billion in 2001. Packers and Stockyards Programs' work in the regulated industries resulted in the recovery or the return of about \$20 million to producers and to regulated industries. The staff is as committed as I am to enforcing the Packers and Stockyards Act and is up to meeting the challenges of the rapidly changing livestock, meat packing, and poultry industries.

Last fiscal year alone, Packers and Stockyards Programs conducted 1,619 investigations in our three areas of regulatory responsibility—financial protection, trade practices, and competition. That same year, Packers and Stockyards Programs conducted 715 investigations to ensure financial integrity of the livestock marketing and meat packing industries.

These investigations include alleged failure to pay for livestock or poultry, failure to pay when due for livestock or poultry, operating while insolvent, failure of market agencies to properly maintain custodial accounts, and the enforcement of the Packers Trust Provision of the Packers and Stockyards Act.

In the area of trade practices, Packers and Stockyards Programs help assure, among other things, that firms adhere to the terms of poultry production contracts; buy and sell on the basis of accurate weight; not misrepresent weights, animal or carcass quality, or prices; have sufficient bond to cover purchases of livestock and poultry; and not discriminate against or give undue preference to certain sellers or buyers.

While there are many examples of investigations into the competition area, in the interest of time, I will share a recent event which most of you are familiar with. The phrase that I always like to use is "working together works." This involves the rumor of foot and mouth disease at a Kansas livestock barn. There, when there were allegations made that this was done to manipulate the market the Grain Inspection Packers and Stockyards Administration, in conjunction with CFTC quickly, did an investigation, and found there was no evidence of violation of the Packers and Stockyards Act.

Over the past 5 years, we have taken dramatic steps to improve our ability to handle competition cases. We have followed the recommendations of the Office of the Inspector General within the U.S. Department of Agriculture and the General Accounting Office

to improve our ability to investigate suspected violations of the Packers and Stockyards Act.

Additionally, GIPSA completed an extensive restructuring in 1999. Packers and Stockyards Programs have been working to recruit, and train new economists and legal specialists, and develop new operating procedures. We have shifted the focus of our employee skill set and are moving away from our traditional investigations. We are working more closely with the Office of General Counsel, and we are developing work plans for every competition investigation.

While these changes may not be readily apparent, they will make a significant difference in our efficiency and our effectiveness. We have undergone a dramatic internal shift in how we look at and deal with the industry. We are trying to make the industry much more aware of the requirements of the Packers and Stockyards Act, and to achieve more open communication with the industry.

While we have been repositioning Packers and Stockyards Programs to more efficiently enforce the Packers and Stockyards Act, the Act itself has not undergone any significant review in many years. Some of the intended beneficiaries of the Packers and Stockyards Programs, including some feeders, producers, and ranchers, have expressed their belief that current market consolidation and new marketing methods facilitate violations of the Packers and Stockyards Act.

Earlier this year, we published our report on the issue of captive supply in the cattle industry. That report clarified GIPSA's definition of the term "captive supply" and compared GIPSA's captive supply statistics to statistics published by other organizations. The report also compared 1999 procurement transaction data of the top four beef packers to the summary captive supply data that the packers submitted to GIPSA.

In addition to the findings of our captive supply study, a significant number of economic studies have been conducted on the short-term effect of captive supply. While some of these studies have shown correlations between the level of captive supply and spot market prices, they have not shown that captive supply causes lower prices or that captive supply would be any violation of the Packers and Stockyards Act.

We know that a wide range of alternative marketing arrangements is emerging and that arrangements have been adopted because the participants believe they are beneficial.

At this time, it is difficult to make important public policy decisions about these arrangements in the absence of sound analysis of the use of these and their implications, given the lack of—

The CHAIRMAN. Mr. Hawks. Mr. Hawks, could you summarize, please?

Mr. HAWKS. OK. I will. What we would like to do at this particular time is to evaluate these arrangements, do a study to look at exactly what is transpiring in the markets, and to be able to provide you, this Congress and this committee, with adequate information to make those determinations.

Thank you, and I would be happy to respond to questions, as well as Administrator Reifschneider.

The CHAIRMAN. Thank you very much, Mr. Hawks.

We are honored to have been joined by a distinguished member of the Agriculture Committee and, of course, the distinguished majority leader of the U.S. Senate, who has also been on the forefront of this fight to try to get some common-sense solutions to getting an open market out there for our livestock producers.

We welcome him to the committee and turn it over to him for any statements he might have, Senator Tom Daschle of South Dakota.

**STATEMENT OF HON. THOMAS DASCHLE, A U.S. SENATOR  
FROM SOUTH DAKOTA**

Senator DASCHLE. Well, Mr. Chairman, thank you very much for holding this hearing and for your extraordinary leadership on this issue. All during the debate on the Farm bill, no one was more stalwart and more vocal and more effective in talking about the need for more competition than our chairman. I publicly again want to acknowledge his leadership and support for our efforts and that of my colleague from South Dakota, Senator Johnson.

Senator Johnson and I toured the State and were home for the entire Fourth of July recess, wherein we held a series of meetings all over the State with farmers and ranchers to talk about their current circumstances. I thought they were some of the most effective meetings and interesting meetings we have had in a long time. They were certainly well attended. Hundreds and hundreds of ranchers and farmers came from all over to express themselves. Basically, their message was pretty simple.

They said that they are facing a double whammy of drought and increasing concentration in the meat packing industry. That double whammy has led to an extraordinarily significant, a precipitous drop in their prices.

It is bad enough that many ranchers across the State are being forced to sell all of their livestock because there is a refusal to provide the much-needed emergency disaster assistance. We have been working now for over 150 days. To date, the administration has opposed providing disaster assistance.

It is even worse that they are being forced to sell their herds into an anti-competitive marketplace because there has been a refusal to pass these much-needed reforms. Herman Schumacher, who I know is going to be testifying shortly, is here on behalf of R-CALF, and he and his colleagues can attest to the circumstances that these producers are facing today. I thank him for coming for this important hearing.

He and many of us have fought these battles together for several years. In fact, 5 years ago last month, it was in June 1997, Herman testified before this committee on the very same issues—the function of the livestock marketplace and the sustained low prices that were occurring even at that time. Then, he said that we needed to do three things: we needed to have mandatory price reporting; we needed country of origin labeling, and we needed improved enforcement of the efforts at USDA.

Well, we have now passed mandatory price reporting, and we have just passed the country of origin labeling, even though we still need to do a lot more.

Senator Johnson and I recently wrote to Secretary Veneman, asking her to investigate these large fluctuations in recent months in price. Her response was that she felt the Grain Inspection Packers and Stockyards Administration, GIPSA, had found no evidence that any unlawful behavior led to the livestock price fluctuations.

Well, producers know that they are being taken advantage of, and they want steps to ensure that competitive marketplaces can be restored. Many of the activities that we hear about are just not right. They may not be illegal technically, but they are not right. They are not right in large measure because our producers have little recourse when they are forced to sell their livestock.

How many times have all of us on this committee heard about the buyer who comes in and tells a producer you have 5 minutes, you have 15 minutes, you maybe have 20 minutes at the most to decide this week whether you are going to sell all of your livestock or not. If you don't take what I am offering, you are going to have to wait several more weeks or you may never get the chance again.

That is exactly the kind of environment that we have to address. There is no competition. When you have that monopolistic pressure, there is nothing that protects the producer. We have to change the laws to ensure that our producers have the legal right to address these problems.

Our goals should be very simple. Ensure fair competition in the marketplace. Producers ought to have more than 5 minutes to decide whether to sell their herds. Ensure market access for big and small producers. Ensure a chance to compete based on quality, and ensure timely action is taken in cases of anti-competitive behavior.

It is unfortunate, in my view, that the House and the administration have so far continually opposed all efforts to enact a ban on packer ownership. We passed it in the Senate. The Senate conferees voted to keep it in the final bill. The House conferees refused to vote on it and have said that it couldn't be in the final bill, and that is where we are today.

We have to ensure that farmers and ranchers have access to markets and real opportunities to compete. Herman Schumacher can tell you this, if he tells us anything, that we can't wait another 5 years for the Congress, for the Government to get that message.

Again, Mr. Chairman, I just commend you for holding this hearing. Of all the issues we are facing in agriculture, I don't know of one that is more important than this. Were it not for your leadership, we wouldn't be here today. I applaud you and I thank you for all that you have done.

The CHAIRMAN. Thank you very much, Leader. Thank you for your leadership in this area.

I would just say that with all that is happening in the marketplace today, we are seeing manipulations by companies inflating stock and kiting and all kinds of things going on, I think we can't forget about this part of our economy either and what is happening with the packers out there that are manipulating and driving these prices around.

Mr. Hawks, I just have one question. Basically, you said, in your testimony, you preferred more study before we consider a ban on packer ownership. For the past 10 years, especially during the past

year on the Farm bill process, we have seen voluminous studies on this subject. There is a lot of information there.

I want to make it very clear: Is it the administration's position that the administration is opposed to a ban on packer ownership as it is presently drafted?

Mr. HAWKS. Mr. Chairman, the administration has not taken an official position on the ban on packer ownership or on your bill.

The CHAIRMAN. Do you suppose I could ever get the administration to ever take a position, Mr. Hawks?

Mr. HAWKS. You probably should. You probably could get the administration—

The CHAIRMAN. Well, when? I mean, we have been through the Farm bill debate. I asked for a position then on this, and I still can't get the administration to say one way or the other. Is it the administration's position that we just ought to have more studies?

Mr. HAWKS. Mr. Chairman, it is my personal belief that we do need additional study. It is my personal belief that we have had a lot of study, there is no question about it, in this area. It is also my personal belief, not the administration's belief, that in some of these studies the outcome was determined before the study was started.

Being a farmer myself, I think that we need to look at situations and try to determine the cause and relationship, not determine how we want the outcome to be and then head in that direction.

The CHAIRMAN. Well, the studies that we have had from independent sources—Senator Johnson mentioned those in his testimony, one from Iowa State and others that were not funded in any way by the livestock industry—all came to the conclusion that there was price manipulation, that there were practices that were anti-competitive because of the four large packers that control, I think, about 80 percent of the market out there. Those studies are there. We have that in front of us.

Let me ask the question perhaps a different way, Mr. Hawks. If the Congress were to pass a ban on packer ownership as it is now drafted, which is a ban on the ownership of livestock within 14 days of slaughter, if the Congress were to pass that, would the administration sign that?

Mr. HAWKS. I cannot answer that, Mr. Chairman, because, as an administration, we have not taken an official position on that.

The CHAIRMAN. One last question, Mr. Hawks. Your testimony indicates you believe that GIPSA has been successful in its mission to protect farmers from anti-competitive conduct. You mentioned that GIPSA had looked at 715 investigations in fiscal year 2001?

Mr. HAWKS. Yes, sir.

Ms. REIFSCHNEIDER. Actually, 1,600.

Mr. HAWKS. Actually, 1,619. There were 715 financial protection investigations, 877 trade practice investigations, and 27 competitive investigations in 2001.

The CHAIRMAN. Well, that is interesting because the USDA report concerning implementing of the Packers and Stockyards Act states that you have not filed one case in this area in the past year and a half. You mean, out of all of these, there wasn't one case you could file? Not one?

Mr. HAWKS. I will let Administrator Reifschneider answer.

Ms. REIFSCHNEIDER. If I could speak to that, actually, you are talking just in the competition area.

The CHAIRMAN. Yes.

Ms. REIFSCHNEIDER. In that area, we have had 27 investigations. As those investigations have come forward, some of those have been settled informally. That is to the benefit of the industry as it works in a shorter process, works to get the problem solved. We have had successes in that, and we do have ongoing competition investigations right now.

The CHAIRMAN. Not one case has been filed in the competition area in the past year and a half. Is that right?

Ms. REIFSCHNEIDER. Yes. You are correct with that.

The CHAIRMAN. Thank you very much.

Senator LUGAR. I have no questions.

The CHAIRMAN. Senator Lugar, no questions. I am trying to remember who came in first, Senator Thomas or Senator Nelson? I am not certain.

Senator THOMAS. Senator Nelson.

The CHAIRMAN. Senator Nelson.

Senator NELSON. Thank you, Mr. Chairman.

The CHAIRMAN. OK, that is right.

Senator NELSON. One question to Secretary Hawks. While we don't have a study that you feel is as informative as a study that you are proposing would be, let me ask you this. Not do you know, but do you believe that there is price manipulation, either because of the size of the concentration or because of outright practices that might involve manipulation?

Mr. HAWKS. Like I said, I am a farmer. I was a farmer until—

Senator NELSON. That is why I asked do you believe in your own experience.

Mr. HAWKS. I was a farmer until I had to divest my interests. I don't think you have ever seen a farmer that took a load of grain to the elevator or a cotton grader that looked at his cotton or a cotton buyer that you dealt with or anything else that didn't think that the person at the other end of the chain was manipulating prices. Having said that, certainly there are some disturbing things going on in this industry, and I—

Senator NELSON. Do they distort the price? Not only are they disturbing, but do they distort the price?

Mr. HAWKS. They are disturbing because they appear to be distorting the price. As I said, there is clearly concern on my individual part. There is clearly concern for the producers out there, and we need to look at this and try to find ways to address the problems.

Senator NELSON. Now, is it possible for us to move forward with something rather than waiting until we have another study? That is the concern. Congress does have a tendency to study things. I don't know if you could say study them to death because things continue to have life around here. They don't seem to die.

The continuous study, ongoing studies may be important, but in the interim, don't you believe we ought to do something, take some action to get some redress for farmers and ranchers today?

Mr. HAWKS. Senator, I do think that we need to, as I said, continue to look at this situation. What I would hate to see happen

is for us to have something that caused an unintended consequence. I would be very careful in the approach that I took. Like I said, it is very clear that there are some concerns here. There are concerns about prices. There are concerns about concentration, no question about that. I would be very careful that we didn't have some unintended consequences.

Senator NELSON. I agree with you in terms of unintended consequences because that is why I said I think not only price stability, but market stability is important. The difficulty that we have is that if we take the level of care that you are suggesting, it is not going to matter much to those that sold all their herd, those that are experiencing the difficulties and the valleys—not peaks but the valleys of low prices and end up on the short end of the economic chain.

We are faced with making some decisions right now. Caution will be exercised in this effort, but I don't—and I hope you are not suggesting that we wait.

Mr. HAWKS. Senator, I would just encourage you to take all appropriate cautions in whatever action—

Senator NELSON. You are not suggesting that we wait?

Mr. HAWKS. That I would caution you to take all cautions in your approach.

Senator NELSON. I hear you. Thank you, Mr. Hawks. That is fair.

The CHAIRMAN. Senator Thomas.

Senator THOMAS. Thank you, Mr. Secretary, for being here. I got the feeling that Packers and Stockyards, in your view, is basically to see that producers are paid promptly.

Mr. HAWKS. Well, we actually—

Senator THOMAS. That really isn't the only issue you have before you, is it?

Mr. HAWKS. No, sir. No, sir. Not at all. Actually, I will let Administrator Reifschneider respond to that one.

Ms. REIFSCHNEIDER. Actually, we work very hard in all three areas. We work in the financial protection area. That is one most people are familiar with. We make sure that producers are getting paid. In trade practices, we again, make sure that producers are being treated fairly with their contracts in the poultry area. We look at contracts continuously in that area. Then, in the competition area, which is newest area that we are addressing and our biggest focus. We do work in all those three areas, and we work in those every day.

Senator THOMAS. With all the response that you have from producers over the years, are you comfortable that there is competition?

Ms. REIFSCHNEIDER. We look at the act and have to follow the Packers and Stockyards Act. We have to look at individual cases as they are brought forward to see if they have merit under the Act and then move forward on specific cases. We look at the industry as a whole when our work raises red flags. We have to look specifically—

Senator THOMAS. What is your conclusion when they raise the red flags and you have looked at it?

Ms. REIFSCHNEIDER. Well, we have had those 27 competitive investigations. Some of those have proved that there is no lack of

competition. I can cite one, and that is the foot and mouth disease rumor that happened in Kansas in March. You know, there was concern that the market was being manipulated. We went, and we investigated immediately and we talked to all people that were in the markets that day to get firsthand knowledge. We did an investigation, and it was proven that—

Senator THOMAS. That is quite a different thing than what we are talking about here, don't you think, the foot and mouth proposition?

Ms. REIFSCHNEIDER. Well, they were looking into whether there was undue market manipulation, and that is a competition area.

Senator THOMAS. You indicate in your statement here that the packers—four firms met 9 percent of their procurement costs through packer-owned cattle and 29 percent through captive supply arrangements. Those numbers are quite different than you hear from everyone else, aren't they?

Ms. REIFSCHNEIDER. There are different definitions for captive supply out there. Our definition is livestock controlled 14 days or more prior to slaughter. Others use 7 days; different packers actually have used different days. Now we are talking to the packers to make sure that we are on target to have the same reports come forward. Our preliminary reports for year 2000 show captive supplies will be about 38 percent, packer-owned 9 percent, marketing agreements 27 percent, and forward contracts 2 percent.

Senator THOMAS. What is the total of that? If those are controlled, what is the total?

Ms. REIFSCHNEIDER. The total would be 38 percent.

Senator THOMAS. No, you had those others added as well.

Ms. REIFSCHNEIDER. No, those are parts of the 38 percent.

Senator THOMAS. Thirty-eight percent?

Ms. REIFSCHNEIDER. Yes.

Senator THOMAS. Don't you feel a little uncomfortable if that is your view from your department relative to what most everyone in the industry is saying?

Ms. REIFSCHNEIDER. In terms of? I am sorry, sir.

Senator THOMAS. In terms of the amount of control packers have over cattle.

Ms. REIFSCHNEIDER. Well, those are a lot of marketing agreements, and people go into marketing agreements for a variety of reasons.

Senator THOMAS. I am not getting an answer, I don't believe. I guess what I am saying to you is it seems to me that it is curious that an agency that is designed to be Packers and Stockyards fairness in marketing has no more feeling about what is going on than you all seem to. I am surprised.

Ms. REIFSCHNEIDER. Yes, sir. Well, certainly, sir. I am a producer myself. I am a pork producer from Illinois. I have been in a variety of marketing agreements, and I have been in spot agreements. I do feel like I do have a knowledge of the industry.

The people that work for Packers and Stockyards are in the markets every day. They are talking to producers. They are talking to market agencies. They are looking at packers. I do feel that they do have a knowledge of what is happening as it relates to the Packers and Stockyards Act.

Senator THOMAS. I just am a little afraid your definition of market control is different than most people's.

Thank you very much.

The CHAIRMAN. Thank you, Senator Thomas.

Senator Wellstone.

Senator WELLSTONE. You know, Mr. Chairman, you want to move it along, and I was down on the floor and I am coming back. I won't ask questions. Just one, to both, just the Secretary and the Administrator, just one heartfelt comment.

First of all, I associate myself with the questioning of Senator Thomas. I really believe this study that you are talking about, I view this as not a step forward, but a great leap sideways. I really do. I mean, I think that is what it is about.

I mean, time is not neutral. Frankly, we are losing all kinds of independent producers. The notion of a study, I think in farm country there is a considerable amount of skepticism, and most people view it like as a great leap sideways. That is what it is, no more than that. I disagree with you, but I thank you for being here.

The CHAIRMAN. Thank you, Senator Wellstone.

Senator Lincoln, I will give you extra time if you want to make an opening statement also, and then——

Senator LINCOLN. No, sir. I can just submit my opening statement for the record.

[The prepared statement of Senator Lincoln can be found in the appendix on page 71.]

Senator LINCOLN. I do have some questions, if I may?

The CHAIRMAN. Yes. Absolutely.

Senator LINCOLN. OK, thank you, sir. First, I would like to thank the chairman, both for the incredible job that he did with the Farm bill. I want to echo what our majority leader mentioned that certainly with your kind of diligence and the patience and perseverance that you showed us with the Farm bill, I appreciate very much your leadership in that area.

Once again, here we are. We find ourselves back continuing a discussion that we began very much in earnest last fall during the creation of that Farm bill. I appreciate very much your leadership, Mr. Chairman, in so many of these issues.

I want to thank the witnesses for being here. Unfortunately, I was detained in the Finance Committee and missed our distinguished colleague Senator Johnson, and all of the work that he has done in this area, I very much appreciate. I am sorry that I missed his testimony.

Mr. Hawks, I am glad to have a familiar accent around here. That is good. You hail from just across the river, I believe, from me in Mississippi. If you could just elaborate perhaps for us on some of the structural changes that we have seen in the livestock or poultry industries in this past decade, and to what extent these changes have been driven by consumer demand or retail purchasing habits perhaps?

Mr. HAWKS. Yes, ma'am. Senator, I really appreciate being able to listen to someone that I can understand as well.

[Laughter.]

Senator LINCOLN. Absolutely.

Mr. HAWKS. There have been a lot of changes that have taken place, as you have alluded to. A lot of these have been driven, we think, by consumer demands, a specific product, whether it is a low-fat product or there are certain products that the consumer is demanding. That is one of the things that is driving some of the changes that we see.

That is the reason that I personally believe that we need a study to look from the farm gate to the consumer to try to look at those relationships, try to understand why a producer is entering into a specific contract.

You know, it may be that his banker is telling him that he has got to move into that contract, that there may be strictly the consumer-driven demands. We need to understand the relationships between the producers, the feeders, the packers, the retailers, and try to draw from that and then evaluate that from a more holistic approach. I can't sit here and tell you why it has gone that way, but I think there are some unanswered questions there.

Obviously, one of them is consumer demand, a desire to deliver a specific product at a specific time in a certain manner is just obviously one of those answers.

Senator LINCOLN. Is there some other industry, I mean, how these changes have compared and changes in other industries? Maybe there is something there that you all have seen in previous studies or something are they greater? Are they more significant than, say, other food retail markets as some that you have alluded to or some of the other industry areas?

Mr. HAWKS. There are a lot of changes in a lot of industries. There has been a lot of consolidation. As you well know, I think there is a little company called Wal-Mart from your home State, and we have seen changes there. I must say to you, to see some of those little small towns where you and I both come from and see Wal-Mart close up those stores it is a little disturbing to us, just like it is a little disturbing when we see what has transpired in the cattle and pork and poultry industry as well.

In business in general, we can look and see the types of things that have changed. You have seen a greater concentration. I am an economist by training. You know, you have certain economies of scale that you have to reach. There are a lot of reasons. I don't think that this industry has any more significant changes than a lot of other industries across our economy.

Having said that, I do think it would be beneficial to have someone outside of agriculture to actually look at these issues. You know, there has been a lot of discussion about maybe having a business school take a look at what is going on here, rather than the traditional approach that we have been taking. You can see a lot of similarities.

Senator LINCOLN. Well, before my time runs out, just one last thing. When we talk about these changes in different industry areas, and particularly in this industry area, have we seen in the export markets, what sorts of changes have we experienced in the export markets of meat and poultry industries that are relevant?

Mr. HAWKS. We have seen a lot of increase in export markets for meat and poultry. As a matter of fact, there has been a tremendous increase in meat and poultry trade with Mexico. Of course, we also

have responsibility for APHIS, and we are responsible for the sanitary and phytosanitary trade issues there. We are constantly dealing with those issues. We are seeing a tremendous increase in our exports. I saw some just astounding numbers on the export of pork when I was out in Denver for the Pork Forum, and Donna probably could answer those questions much better than I.

We have seen a tremendous increase in exports. We are exporting grain through our meat.

Senator LINCOLN. That is right. Well, you sound like a row cropper, so I think that is why we also understand—

[Laughter.]

Mr. HAWKS. I grew up on a dairy farm, and I had beef cattle, too. I have experience in all of it.

Senator LINCOLN. OK. Right. Thank you, Mr. Chairman. I appreciate it.

The CHAIRMAN. Thank you, Senator Lincoln.

Just one followup, Mr. Hawks. I just heard you mention that perhaps we ought to have someone outside of agriculture take a look at this. You mentioned, for example, a business school. When you say “take a look at it,” do you mean take a look at what is happening in the livestock industry overall?

Mr. HAWKS. Yes, sir.

The CHAIRMAN. Well, again, I repeat for emphasis sake, that we had four individuals: John Connor, Professor of Agricultural Economics at Purdue; Peter Carstensen, Young-Bascom Professor of Law at the University of Wisconsin School of Law, and Associate Professor of Agricultural Economics at Wisconsin School of Law; then we had Roger McEowen, who is Associate Professor of Ag Economics at Kansas State University; and then, we had Neil Harl, who is the Charles Curtiss Distinguished Professor in Agriculture and Professor of Economics at Iowa State University. Those four are not in agriculture.

Mr. HAWKS. They are all agricultural economists.

The CHAIRMAN. That is true, but they are not paid by the livestock industry. They have no connections with the livestock industry. They are independent thinkers. Have you read their report?

Mr. HAWKS. No, sir.

The CHAIRMAN. You have not?

Mr. HAWKS. No, sir. I have not read their report.

The CHAIRMAN. Well, Mr. Hawks, could I just ask you to please read it?

Mr. HAWKS. Yes, sir. If you would be—

The CHAIRMAN. Would you do it?

Mr. HAWKS. Yes, sir.

The CHAIRMAN. Would you read it over?

Mr. HAWKS. Yes, sir. If you would—

The CHAIRMAN. Because it came out—

Mr. HAWKS. I would certainly read it.

The CHAIRMAN. Well, this report came out, I think—when? Was it earlier this year, or when? About mid-March, I am told it came out, and I would like you to take a look at this. It is “The Ban on Packer Ownership and Feeding of Livestock: Legal and Economic Implications.”

Here are four people not in the business, not paid by packers or meat processors or anybody else, independent thinkers, from four different universities that are taking a look at it. I just recommend it and ask that you read it. You said that you would, and I would appreciate that. Maybe in writing, you could respond.

I would ask you to read it and maybe you could respond in writing to your views on this after you read it.

Mr. HAWKS. Yes, sir. I would be happy to do that. As I have just been informed that this study, the reason that I have not read that study was the study that we were talking about doing was much broader in scope. As I was saying, this was one of these very narrow scope studies. I will certainly read it and respond to you.

The CHAIRMAN. We would be willing to take any suggestions you have on—again, I must be honest for the record. I don't believe we need another study. We have been studying this for 10 years. If you have a recommendation for a study that is more encompassing in scope, I would be more than willing to take a look at it and consider it and see if maybe the committee might want to move in that direction.

Mr. HAWKS. I would certainly appreciate that, and I will be forwarding that to you.

The CHAIRMAN. I appreciate that. Thank you very much, Mr. Hawks, Ms. Reifschneider. Thank you very much.

[The prepared statement of Mr. Hawks can be found in the appendix on page 73.]

The CHAIRMAN. We will move to our second panel now. That would be Mr. Michael Stumo, Mr. Tim Bierman, Mr. Nolan Jungclaus—I hope I got that right—Mr. Steve Appel, Mr. J. Patrick Boyle. That is it.

Again, as we said to the other panel, your statements will be made a part of the record. If you could summarize it in 5 minutes, I would certainly appreciate that so we could get to some questions. I will just go in the order in which I called everybody.

I am informed that it is not “Stumbo,” it is Stumo. OK? Mr. Michael Stumo, general counsel for the Organization for Competitive Markets out of Lincoln, Nebraska.

Again, Mr. Stumo, as I said, all of your statements will be made a part of the record in their entirety. If you could summarize for us your main points, we would be most appreciative. Mr. Stumo.

**STATEMENT OF MICHAEL STUMO, GENERAL COUNSEL,  
ORGANIZATION FOR COMPETITIVE MARKETS, LINCOLN,  
NEBRASKA**

Mr. STUMO. Thank you, Mr. Chairman. Thank you, members of the committee for holding this hearing.

OCM, the Organization for Competitive Markets, is a membership/think-tank group. Our members are farmers, ranchers, academics, policymakers, and ag business leaders. We focus on agricultural antitrust issues only.

I would like to talk today initially about the role of government in the marketplace, which is, in our view, and I think as proven by the antitrust precedent and the competition precedent in this country, to create and maintain the infrastructure for the most companies and people to engage in commerce.

I would ask you to consider the metaphor of the Internet or the U.S. highway system, which are infrastructures also that facilitate commerce. They are not commerce in and of themselves, but they facilitate commerce. They are characterized by inexpensive access, equitable rules for participation, and they have lots of on and off ramps. GE, General Electric, uses this infrastructure for commerce, and so does my mother.

It may be efficient for a few dominant firms to cordon off a large section, 50 percent or 90 percent, of the infrastructure—the Internet or the U.S. highway system—but only for internal efficiency of those companies. If others are excluded from using that large swath of these systems, we forego a tremendous amount of commerce by those other potential commercial participants.

Now, as we are looking at promoting proper market operation, I think we need to focus on what the goals are and where it has worked. For example, in the stock markets, the SEC has focused for a few years on the principles of fairness, access, transparency, and then, in this case, competition.

Fairness is participating on equal terms. If I buy stock or Warren Buffet buys stock, we buy stock at the same price. We have the same public information available. He may analyze it better, but we have the same price of stock. He doesn't get bulk rates on IBM stock. We get the same price.

We have access. We have equal access. I can buy and sell anytime, though I am a small player. There is transparency because we don't have GE disclosing company information to the chosen few. It is disclosed to everyone. If they disclose to the chosen few, it is a violation of the law. Should it be in agriculture?

Now, the efficiency defense, also this consumer demand defense—but the efficiency defense, how does one look at it? At what point does efficiency overcome these fairness, access, transparency, and competition principles? There is a series of questions that should be asked.

A, is it real? Is the efficiency real? I think a lot of times what has been claimed as an efficiency is not real here.

B, is it directly related to the practice that is at issue?

C, is there no other alternative to achieving that efficiency other than the practice at issue?

Last, if it passes those tests, is that efficiency gain or those efficiency gains likely to be passed to the consumer, given the industry structure? Otherwise, it is just an intra-firm issue, not a public policy issue.

Then, once the efficiency claims have passed those tests, to the extent they have, whatever is left then can be balanced against a competitive positive effect of the rules that we are talking about. We need to look, just as we are looking in accounting and in the stock market system, we need to look at the incentives.

We argue about past harm. We have for 10 years with studies. The incentive system is what we need to look at, the motive or opportunity to act and strategically for your own advantage and against the public interest.

Captive supplies, in our view, we need to look at them through that lens of incentive. Captive supplies violate the market-facilitating principles that I just outlined, in our view, because they result

in market closure, or cordoning off the highways, the on and off ramps; market unfairness—in this case, Buffet gets great deals on GE stock and I don't; and gaming the system.

The market closure we have already talked about a bit because we have 16 percent, 17 percent or so open market hogs claimed by the Grimes and Plain study of March 2001.

Now, what does that really mean? Are those actually negotiated and bid? No. It just means they are not under contract and they are not packer owned. Some are relationships. Some just have to go to a packer. What is setting the price out here? The Iowa-southern Minnesota market is setting the price. Anywhere else, the open market hogs are just following.

We have 3 percent to 5 percent of the hogs, in my view, setting the price for the entire country for the open market and for the formula hogs. We have very large, dominant firms interacting. They are repeat players every day in a market that is very thin.

Now, market unfairness. We have people that have access problems. We are not even talking about bid problems now. We are talking about differentiations in access because we have the market so closed down that you get access by permission only. That is it.

If you want to be a beginning farmer, the corporate executives give you permission, then you can play. If they don't, you don't. It is not a matter of getting financing, getting loans, that thing. We are closing down. It is by invitation only.

Now, gaming the system. Where have we seen this recently? Of course, Enron, Dynegy, gaming the system in California energy trading markets. They use these trading strategies called Death Star, Fat Boy, Get Shorty. What does that mean? They are fictitious transactions or agreements that create false gluts or false shortages. The price reacts, and they trade into the situation that they created. Is it in captive supplies.

The CHAIRMAN. Sum up here pretty soon.

Mr. STUMO. OK. They can create false shortages or gluts. In this case, they pull out of the market. The price drops. They pull out of the market with scheduling. The price drops, and then they go and jump into the market at that time.

Now, key issues. Bob Peterson said in 1988 to the Kansas Livestock Association, as we are debating this. He is the former CEO of IBP. "Do you think packer feeding and forward contracts has any impact on the price of the cash market? You bet. We believe a significant impact."

Wayne Purcells said in 2000, "Whether buyers attempt to manipulate the cash market to which the contract price is tied is somewhat immaterial because the incentive to do so is present and is undeniable." There is really agreement here.

Last, on USDA, their enforcement. We really need to focus on rulemaking. Justice has guidelines on how they view mergers and antitrust scenarios. We have no regulations defining unfairness, defining as deceptive practices, defining undue preferences in GIPSA. There are no guidelines defining these competition terms, so the investigators are relegated to an "I know it when I see it" approach. Thus, that has to be changed.

Thank you.

[The prepared statement of Mr. Stumo can be found in the appendix on page 78.]

The CHAIRMAN. Thank you, Mr. Stumo.

Now we turn to Mr. Tim Bierman, president of the Iowa Pork Producers Association from Larrabee, Iowa. Good to see you again, Tim. Welcome.

**STATEMENT OF TIM BIERMAN, PRESIDENT, IOWA PORK  
PRODUCERS ASSOCIATION, LARRABEE, IOWA**

Mr. BIERMAN. Good morning, Mr. Chairman. My name is Tim Bierman. I am a pork producer from Larrabee, Iowa. I am the president of the Iowa Pork Producers Association. I like to joke that in my spare time, I am the owner/operator of a hog farm that markets over 10,000 a year. I also farm nearly 500 acres of corn and soybeans. I appreciate this opportunity to present our views today.

The Iowa Pork Producers Association is the oldest and the largest pork producer group in the country. IPPA represents well over 6,500 producers on issues ranging from international trade missions, pseudorabies eradication, ag policy, and environmental regulations. Our industry provides over 86,000 jobs in the State and contributing nearly \$3 billion in payroll income to our State's residents. If you look at our total economic impact in the State of Iowa, our producers affect nearly \$12 billion in the State.

We represent many different types of operations from the small operators to the large multi-family operations. Iowa is the largest pork-producing State, producing more than a quarter of the U.S. production alone. Iowa has held that distinction since 1890. We are one of the few States with a ban on packer ownership of livestock. Let us take a moment to reflect on that point, Mr. Chairman.

Iowa has had a ban on packer ownership since 1975, and we are still the largest pork-producing State in the Nation. We have more packers than any other State, with a ban on packer ownership. In Iowa, we still have some packer competition for hogs and the highest prices in the country.

However, Mr. Chairman, I must admit not everyone is pleased with Iowa's approach. I am sure the committee is aware that Smithfield Foods from Virginia has filed in Federal district court against the State to challenge Iowa's ban of packer ownership.

In any event, the Iowa Legislature has amended the ban on packer ownership during two of the last three legislative sessions, and the legislature has voted unanimously both times affirming Republicans' and Democrats' faith in the law. In addition to our organization, others supporting the legislative change were the Iowa Farm Bureau and Iowa Farmers Union.

Just for some perspective, we polled our members recently on the ban on packer ownership. Ninety-two percent are supportive today, and that is an increase from 88 percent from the year before. We are the only livestock organization, to my knowledge, which has formally polled their membership on this issue. In fact, we have also heard from a number of Iowa packers who say they don't want to own livestock.

A Federal ban on packer ownership of livestock is needed because all hog farmers need more competitive markets. This hearing

couldn't have come at a better time. Producers are worried sick about a return to the Depression era prices this fall similar to those experienced in 1998 and 1999. Economists are predicting some pretty low prices this fall, and those low projections are contingent on all plants maintaining maximum capacity.

Nonetheless, I have been deeply concerned with some of the debate that occurred as Congress discussed a ban on packer ownership during the Farm bill debate. I believe the Senate showed leadership in the face of packers threatening plant closures, which, by the way, Mr. Chairman, I believe was in very poor taste.

I am also disappointed that the special interest groups, saying they are producer-driven groups but align themselves with packers, scuttled the legislation in conference. I believe it was at the expense of the typical producers like me.

We appreciate your leadership, Mr. Chairman, but wish that many of your conference colleagues shared your views. We realize that there can be regional differences of opinion. Despite these regional differences, our producers convinced their fellow farmers from across the country to change our national organization's position on packer ownership from against to neutral as the official policy of the National Pork Producers Council.

You have to understand the internal dynamics of the organization to realize that this is a major departure from its past views on this matter. Why did the delegates to the National Pork Producers Council change their views? Again, because farmers demanded the change. Not the packers, but the farmers. A ban on packer ownership of livestock should not be a game of political football. It is what the independent farmers want.

These are several reasons we should support a ban on packer ownership of hogs. The obvious reason is that vertical integration controls both supply and demand for live hogs. Furthermore, vertically integrated companies can shift profits and losses from between slaughtering operations and the live hog operation, which typical farmers can't do.

Finally, vertical integration makes price discovery for animals almost impossible because animals are not sold, they are internally transferred. I have attached an outline of an Iowa packer feeding law to my written testimony, but I will briefly review what it does and does not regulate.

The Iowa law forbids packers from owning, controlling, contracting for production of hogs, and from financing a hog operation. Marketing contracts are specifically exempted. This year, the law changed to allow for limited exemptions for new qualified processors. The law limits their size and allows farmers to become equity holders, but only up to 10 percent for each farmer. The entity must be 60 percent owned by farmers, and they must agree to 25 percent of their daily slaughter to be nonshareholders by negotiated sales.

This approach was also discussed in the October 1999 NPPC press release, which stated, "More negotiated sales would help ensure prices reported for the spot market to reflect current value of hogs."

We urge this committee to give producers the opportunity for success. Concerning enforcement of the Packers and Stockyards

Act, a difficult task continues for USDA's Grain Inspection and Packers and Stockyards Administration. Implementing Federal mandatory price reporting law is a step in the right direction, but continued market oversight is now crucial.

In addition, there has been some procedural changes within mandatory price reporting that are disturbing pork producers. One change is USDA has accepted all negotiated bids for calculating the simple average of market hog prices. Previously, USDA would exclude extreme bids from extremely small lots, for example. While on the surface including every bid appears to be consistent with the intent of the law, this policy has been encouraged what is commonly called "bottom feeding."

However, one of the best tools of mandatory price reporting is the weighted average prices paid. This takes into account the prices paid and the volume of various prices. If USDA cannot determine how to throw out extreme prices for the simple average, they could mandate a weighted average price be used in certain formula contracts.

The CHAIRMAN. Tim, could I ask you to sum up?

Mr. BIEMAN. In closing, IPPA is committed to a fair, transparent, and competitive marketplace. Our producer members constantly remind us of our duty.

Mr. Chairman, thank you for holding this important hearing and for giving me the opportunity to address the committee. Thank you.

[The prepared statement of Mr. Bierman can be found in the appendix on page 90.]

The CHAIRMAN. Tim, thank you very much.

Senator WELLSTONE. Mr. Chairman. Mr., Chairman, I mean, that was exceptional testimony, especially coming from Iowa.

[Laughter.]

The CHAIRMAN. That is always standard for someone from Iowa to have exceptional testimony, I say to my friend from Minnesota.

Now we go to Mr. Nolan—I want to make sure that I have this pronounced right, Junglaus?

Mr. JUNGCLAUS. Junglaus. Yes, like a Y.

The CHAIRMAN. Junglaus, from Lake Lillian, Minnesota.

**STATEMENT OF NOLAN JUNGCLAUS, HOG FARMER, LAKE LILLIAN, MINNESOTA**

Mr. JUNGCLAUS. That is right. I would, too, like to thank you, Chairman, for holding this hearing. My name is Nolan Junglaus, and I am a grain and livestock producer from Lake Lillian. I raise 450 acres of crops, 80 of which will be certified organic this year. We also have a very small farrow-to-finish hog enterprise in which we raise up to 600 head of antibiotic-free pork.

This has not always been the case. In 1994, our farming operation made a major transition as a conventional corn and soybean grain farm, typical in our area, to a more diversified and sustainable farming business. Through the introduction of livestock enterprise and the diversification of cropping systems, we have been able to improve farm efficiency and profit despite the currently depressed farm economy.

My affiliation with Minnesota Farmers Union, the Land Stewardship Project, and the Minnesota Sustainable Agriculture Pro-

gram has helped our family recognize the very positive social, economic, and environmental impacts that our farming operation has on our local community.

I have changed from just a commodity farmer, who likely would have become another statistic in the declining rural economy, to a board member of Prairie Farmers Cooperative, an innovative \$5.8 million hog processing plant in Dawson, Minnesota. The co-op is owned by 82 local family farmers and can process approximately 65,000 hogs annually, thus allowing us to stay on the land, capture more market value, and reinvest some of that value back into our communities.

Since the transition of our farm in 1994, I have witnessed ever-increasing vertical integration in the livestock industry—a concentration of economic power and wealth spearheaded by packers who own and feed their own livestock. This shift in the economic balance from the rural sector to the corporate headquarters of the very large and monopolized packing industry is sucking the lifeblood out of our rural communities.

The six major packers owned 1.2 million sows in 2001. Based on my knowledge and experience of raising hogs, that results in more than 30.4 million packer-owned market hogs per year, which means six packers slaughter about 120,000 of their own hogs every day. The number of sows owned by packers has tripled since 1996. These six pork packers own 432,000 sows.

I don't believe it is coincidental that hog farmers' share of the pork retail dollar has plummeted from 42.5 cents in 1996 to just 30 cents in 2001, a drop of 29 percent. That money is taken out of my pockets, money that is not circulating in my community. It is hurting us severely.

Currently, only 17 percent of the hogs are sold on the open market. The rest are either packer owned or under long-term contracts that are neither public nor open to bid and are routinely offered to only the largest operations.

The corporate greed we are reading about daily in our news has many faces. Stealing, whether it is through creative accounting or manipulating markets, is an unethical practice that is undermining our Nation and our national security.

Packer ownership and captive supplies means minimal demand for our hogs. We get a lower price because packers are filling demand with their own hogs. We can participate in the market only after the packer-owned hogs and those they have on long-term secret contracts have been used.

They then offer a so-called price, a price below market value that, in effect, steals our hogs. This is not the workings of a competitive market. It is a racket that is killing the roots of our society and undermining the fabric of free access to opportunity for farmers and all Americans in the rural sector. It leaves us with a very bad taste in our mouths about corporate greed and the unwillingness of our government to do anything about it.

The Senate had originally done the right thing by passing the packer ban. I know that industry lobbyists are working overtime in DC to kill the packer ban. I now hear that some people say that we need a study. Out here in the rest of America, we see that for what it is—a corporate-generated stall tactic. A study will do noth-

ing for family farmers, while allowing the packers the opportunity to control the rest of the hog industry and an increasing share of the beef industry.

I don't need a study to tell me the effects concentration has on Lowell Petterson, who owns and operates our local hardware store, the man who fixes our church's boiler and never sends us a bill. I don't need a study to see the impact that consolidation has on Bob Hall, who owns our local grocery and is forced to live on ever-tighter margins as packers and large retailers work together to eliminate competition.

I don't need a study to show me that hardships our local businesses face directly impacts our church's offering and the tax base that supports our schools and hospitals.

It is time to take action and pass the packer ban on ownership of livestock. It is time for our elected representatives to take responsibility to ensure that democracy works for the greater good of all Americans.

The path we are on is leading us in the wrong direction. Packer ownership of livestock leads to unfair competition, to bad market economics, and to a vertically integrated system in which producers become serfs to corporations. Let us get back to the basics, like our congressional leaders did in the 1920's when they passed the Packers and Stockyards Act.

The act worked until our leaders lost the political will to enforce it. I urge Congress to revive the will, to strengthen and enforce the Packers and Stockyards Act. Additionally, Congress should pass legislation that requires marketing contracts to be bid on an open and public market. Secret deals between packers and the largest producers create many problems, including the pervasive sense of unfairness and the opportunity for corruption.

Legislation has been introduced by Senator Enzi that would require marketing contracts to be traded in open public markets, such as an electronic market in which all buyers and sellers could have access. We have the technology and the funding provided in the Rural Development Title of the recently passed farm bill to make this happen. This legislation would establish an open marketing system and allow farmers to compete and ultimately profit in livestock production.

Mr. Chairman, I urge Congress to uphold the principles that made this Nation great. Passage of the packer ban on ownership of livestock, enforcing and strengthening the Packers and Stockyards Act, and Senator Enzi's legislation addressing captive supply will restore competition to farmers and reinforce the pillars of our democracy.

Mr. Chairman, I would like to thank you for this opportunity to testify today, and I would be very glad to answer any questions you might have for me later.

[The prepared statement of Mr. Jungclaus can be found in the appendix on page 97.]

The CHAIRMAN. Mr. Jungclaus, thank you very much for your testimony.

Now we turn to Mr. Steve Appel, vice president, American Farm Bureau Federation, from Endicott, Washington. Welcome, Mr. Appel.

**STATEMENT OF STEVE APPEL, VICE PRESIDENT, AMERICAN  
FARM BUREAU, ENDICOTT, WASHINGTON**

Mr. APPEL. Thank you, Mr. Chairman. My name is Steve Appel. I am vice president of the American Farm Bureau Federation and also president of the Washington State Farm Bureau. Actually, I like to claim Dusty, Washington, Mr. Chairman, rather than Endicott. It is a thriving community of approximately 20 people.

The CHAIRMAN. Wow. I thought I came from a small town.

Mr. APPEL. Real rural America.

The CHAIRMAN. Yes.

Mr. APPEL. I appreciate the opportunity to present testimony today on behalf of the AFBF. Increased concentration in agricultural markets has frustrated many farmers and ranchers because producers believe that an increased concentration results in less market competition. Less market competition means less price transparency and can often result in lower prices.

AFBF believes that prohibiting packer ownership of livestock would reduce concentration and allow the independent producer more access to the competitive marketplace. Allowing packers to stay out of the cash market for extended periods of time reduces farm gate demand. The result is reduced market access for small and medium producers.

In recent years, many livestock producers have engaged in various marketing arrangements with packers to assist in profitability, consistency in product, guaranteed marketing of product. Such arrangements provide a premium for the producer and a certain delivery date for the packer.

Farm Bureau supports the ability of producers to forward contract, participate in grid and formula pricing and other risk management tools, but we believe that allowing packers to own livestock reduces competition in the marketplace. We worked diligently with staff members during the Farm bill debate to clarify the issue of control and supported the language included in the Senate-passed Farm bill that would have allowed risk management tools for livestock producers.

There are many questions and concerns regarding the prohibition of packer ownership. Those opposed question the ability of the packers and retailers to continue the excellent and diverse product development and marketing of livestock products that has resulted in increased demand, both domestically and internationally. Since there is such a strong demand for these products, we believe their development will continue regardless of whether there is a prohibition on packer ownership of livestock.

Another argument against the prohibition of packer ownership is that the poultry industry would have a further competitive advantage over pork and beef industries if packer ownership were prohibited. Poultry and beef are two completely different types of protein. If there is currently a competitive advantage for poultry, we believe that it is mostly attributed to product development and case-ready meat that can be easily prepared.

There are also concerns about the availability of carcass data currently available and used to further improve production management. Improved carcass data is assisting producers to meet the livestock specifications needed by the packers. The availability of

that information should not diminish as a result of prohibition of packer ownership.

Many buyers and sellers characterize a truly competitive market. Concentration in agriculture is increasing. When the number of buyers is reduced, downward pressure on price may result. As marketplace volume decreases, the market is far more susceptible to intentional or unintentional actions taken by the dominant buyers.

If a plant shut downs or a packer pulls out of the market for other reasons, prices suffer. There is increasing concern among producers that some packing plants may shut down, and reduced slaughter capacity typically means lower prices for producers.

The Packers and Stockyards Act was enacted to deal with problems associated with concentration. Its regulations prohibit sale barns and auction markets from vertically integrating. Specifically, stockyards may not own or control buying stations, packing plants, or livestock feeding operations. The rationale is that such ownership or control creates conflicts of interest, access problems for other producers, and opportunities for self-dealing, which distorts the market.

The procurement of cattle and hogs has changed dramatically since the Packers and Stockyards Act was passed 80 years ago. At that time, cattle were primarily sold at auction markets to the packers. Today, most cattle are sold directly off the feedlot to the packing plant.

Farm Bureau believes that because the meat packers are similarly situated to the stockyards as a market creator and market forum, the same rules in PSA should apply to them. In fact, more concentration exists today among the packing industry than existed at the time that PSA was originally passed.

The prohibition of packer ownership of livestock is a passionate and controversial issue. Such a ban will not solve all of the issues of livestock concentration and cyclical price fluctuations for producers. However, it may assist independent producers in securing a competitive marketplace and a transparent price discovery system.

There are many questions to be asked regarding livestock concentration and how to achieve a fair, competitive marketplace for all segments of the industry from producer to retailer.

We appreciate the hearing today and the opportunity to discuss this important issue with the committee. Thank you.

[The prepared statement of Mr. Appel can be found in the appendix on page 100.]

The CHAIRMAN. Thank you very much, Mr. Appel, for a fine statement.

Now, we turn to Mr. J. Patrick Boyle, president of the American Meat Institute here in Washington, DC Mr. Boyle, welcome.

**STATEMENT OF J. PATRICK BOYLE, PRESIDENT, AMERICAN MEAT INSTITUTE, WASHINGTON, DC**

Mr. BOYLE. Thank you very much, Mr. Chairman, Senator Lugar, members of the committee. I appreciate the opportunity to be invited to testify here today before the committee. As you may suspect, we have a somewhat different perspective on the marketplace, and I am happy to have the chance to share it with the members of this committee.

The business practices of AMI's 250 member companies are governed not only by the Sherman Act, the Clayton Act, the Robinson-Patman Act, and the Uniform Commercial Code, but also by the Packers and Stockyards Act, a statute unique to our industry that clearly prohibits meat packers from engaging in unfair or deceptive business practices that disadvantage their livestock suppliers.

Yet, ironically, we are here today, as we have been here many times before, not just in recent years, but in recent decades, to discuss whether meat packers should receive yet additional scrutiny, enforcement, or business restrictions in order to protect and benefit livestock producers.

I must say, Mr. Chairman, these topics just never seem to go away. They were around when AMI was founded in 1906, and they have persisted now for nearly 100 years.

Could it be, as some suggest, that our laws are inadequate? Or is our enforcement poor? Or maybe we haven't done a good job identifying evolving competitive factors and coming up with meaningful understandings of today's marketing realities.

I believe the latter is the closest to the truth. In that regard, I commend those such as Senator Craig and Secretary Hawks, who have recommended a thoughtful, reasoned approach of studying the meat and poultry marketplace and the evolving corporate business models amongst producers and packers and then identifying potential areas for improvement.

AMI members have one common objective: to produce products that consumers desire. It is the consumer who determines the type and value of our products, which, in turn, determines the type and value of our raw materials. In order to create the foods people want to buy, AMI members have done many things, including increasing their coordination with livestock producers so that the raw materials comport with consumer demand for finished products.

This increased coordination has led to increased vertical integration or vertical cooperation through contracts, which has sometimes included complete or partial ownership of some of each packer's livestock supply.

While the trend has caused some concerns in various parts of the country, as evidenced by some of the comments here today, the trend has also resulted in increased coordination between producers and packers that have generated a number of benefits.

For example, it has allowed the industry to offer to consumers leaner beef and pork products. Second, it has allowed the development of value-added, often branded meat products, which consumers increasingly desire. Third, it has improved risk management and financial options for producers.

I want to focus upon that one benefit that I mentioned at the end, the improved risk management and financial options for producers. The volatility inherent to farming and ranching has been reduced for many livestock producers through the increased use of contracted sales with meat packers and other creative risk management plans. In fact, many lending institutions throughout rural America require such contracts as a condition of making a loan to a livestock producer.

The benefits to farmers were perhaps most vivid during the very difficult fourth quarter of 1998, when the spot market price for

hogs crashed. They dropped to as low as \$9 a hundredweight. Those farmers with risk management contracts had locked in much higher prices from their packers for their hogs, generally in the \$35 per hundredweight range, and were protected because of the contracts.

AMI strongly opposes efforts that would make it illegal for meat manufacturers to do what the rest of the global business community is doing, which is to form relationships with suppliers of raw materials in order to produce consistent quality, value-priced products that consumers desire. In our view, the proposed ban on packer ownership, control, or feeding of livestock would do just that.

Further, we are opposed to any effort to restrict meat packers who comply with existing antitrust and fair business practice laws from sourcing their raw materials from livestock producers in any way the parties deem mutually beneficial.

Over the last three decades, Americans have benefited from increasing meat industry efficiency that has made meat more affordable, abundant, convenient, and varied. Each year, consumers spend less of their disposable income on meat and poultry products. Today, that number stands at 1.9 percent of their disposable income, compared to 4.1 percent 30 years ago in 1970.

There have been a number of comments here today, Mr. Chairman, about livestock prices, producer losses, meat packer profitability, and I would like to submit for the record two charts which summarize the past 13 years of pricing within the beef and pork sector. These charts are based upon USDA data.

This first one shows the spread between farm prices for hogs, which is the green line at the bottom; wholesale pork prices that the packers receive, which is the red line just above the bottom line. Then the top line is the retail value of pork in the marketplace.

You will see that, despite some of the concerns and statements made here today, the amount of money that livestock producers make for their hogs, in this case, tracks almost in tandem up and down with the wholesale prices the packers are receiving for the pork in the wholesale market.

The CHAIRMAN. I am sorry, Mr. Boyle. I am sorry. I had an urgent call that just came through. Explain that, the top line is the retail?

Mr. BOYLE. Yes, the top line is the retail value of pork in the grocery market.

The CHAIRMAN. Going back, what is the beginning year there?

Mr. BOYLE. It is 1989.

The CHAIRMAN. OK.

Mr. BOYLE. It trends through January of 2002. Then, the red line is what the packers are receiving in the wholesale marketplace for their pork, fresh pork. The green line is what hog producers are receiving from the packers for their market hogs as we buy them in the marketplace.

The important point here is that, despite the comments that producers aren't making money and that packers are making enormous profits, if you look at the USDA data over a prolonged period of time, you will see that when livestock prices go up, the wholesale price the packer receives goes up accordingly. When livestock prices

go down, the amount of money the packers receive goes down accordingly.

I would just show you very briefly the same trend line over the same period of time also based upon USDA data for cattle, wholesale beef, and beef in the retail marketplace. You will see that, in many instances, the amount of money that the packers are paying for the live cattle actually exceeds on a per-pound basis the price we are receiving in the wholesale market for boxed beef.

The point of these two charts is that there is not undue profiteering occurring at the expense of producers. In fact, the returns to producers track through the last 13 years the returns to packers. This return has been constant, even though for the last 10 years in the beef sector, the concentration rate of the top four has remained virtually unchanged. In the pork sector, the concentration rate for the four largest pork packers has actually gone from below 40 percent to upwards of 55 percent.

Despite increasing concentration, the amount of money that goes to producers and packers has remained constant and in tandem throughout that period of time.

Mr. Chairman, I appreciate again the opportunity to be with you today and look forward to answering any questions that you and your fellow committee members may have.

[The prepared statement of Mr. Boyle can be found in the appendix on page 105.]

The CHAIRMAN. Thank you very much, Mr. Boyle. I don't have those charts. Were they in your testimony?

Mr. BOYLE. No, I apologize for that, Mr. Chairman. They were not. They were on my desk chair this morning, and I thought they might be of interest to the committee. I am happy to submit them for the record.

The CHAIRMAN. If you could get those for me on 8.5-by-11 or something like that, I would appreciate it.

Mr. BOYLE. I would be happy to do so.

The CHAIRMAN. Thank you.

The CHAIRMAN. Mr. Stumo, Mr. Bierman, Mr. Jungclaus, Mr. Appel, you are all producers. Again, I think you have heard from Mr. Boyle, who has said that basically it has remained constant, if I can just interpret that, that the wholesale-retail price spread. Was that what you were saying, Mr. Boyle?

Mr. BOYLE. The price to livestock producers for cattle and hogs has moved up and down in tandem with the amount of money that packers have received for beef and pork in the marketplace over the last 13 years. In fact, if I put a chart together over the last 30 years, the trend line would remain constant.

The CHAIRMAN. I have another chart here, which I could give to you, but it is the farm to wholesale price spread for pork. In 1993, it was \$29. Farm to wholesale price spread for pork in 1993 was \$29. In 2001, it was \$43. That is about a 50-percent increase in 10 years.

Mr. BOYLE. I don't have this information in exactly that manner, but I wouldn't necessarily agree with that. The spread here, if you look from the farm, which is the green line, to the retail has actually increased over that period of time. The spread from livestock prices to retail prices has increased.

The CHAIRMAN. Where is your wholesale price line?

Mr. BOYLE. This is the wholesale price line, and it has remained virtually unchanged in terms of a margin between livestock prices and wholesale prices. This is what the packers receive.

When the price is up in the wholesale beef or pork price, the livestock prices that the packers are paying for hogs and cattle tracks up accordingly. When our wholesale prices that the packers are receiving in the marketplace down, correspondingly almost in tandem over the last 13 years, the prices that we are able to pay for hogs and cattle down.

The CHAIRMAN. The farm to wholesale price spread for beef in 1992 was \$25. In 2001, it was \$37, another 50-percent increase. Now, again, we are going to have to correlate our different figures here. That tells me that something is happening in the marketplace where you are getting a big farm to wholesale price spread on this. We are going to have to have some more look at why these figures seem to be different, I don't know.

Mr. BOYLE. Well, I would be happy to take a look at the figures upon which you are relying, and I am more than happy to provide for the committee the ARS data that we have used to put these charts together, Mr. Chairman.

The CHAIRMAN. I appreciate it. Just my general question again for the panelists who are here is what is your own personal experience in the competitive marketplace, both for hogs or for cattle? Since You have been in the business, I think, for at least 10 years, I mean, what have you seen happening out there? Just in your own words, what are you looking at out there? You hear basically it hasn't changed a bit.

Mr. BIERMAN. Mr. Chairman, if I may address that?

The CHAIRMAN. Sure. Sure.

Mr. BIERMAN. Well, 5 years ago, it was much easier to get different bids from packers for hogs. Nowadays, last week, I was talking to a producer from Sioux Center, and he feels that he has only one choice left to place, to sell his hogs because the other packers are not responding to him when he is asking for a bid.

In the last 5 years, things have changed dramatically. If we don't do something soon, it—I mean, he will not have a choice. He will either have to align himself with a packer or get out of business.

Mr. STUMO. Mr. Chairman, we are not even getting bids. I don't produce hogs. I did buy hogs 10 years ago, or in 1989. I was a buyer. I have six pigs right now. One of our board members who has 200 sows and I, well, I asked him, "How many bids do you get?" You know, you are in Iowa. You have more packers than anywhere else, despite this awful packer ban that should drive them elsewhere. "How many bids do you get?"

He says, "Bids? We don't get bids. We get slots. They tell me you can come in on this day, and I get one packer that will give me slots, and we will tell you the price when you get here." Then, whatever price that they unilaterally give when he gets there, that is reflected in the open market.

I would also state on this farm to wholesale point that you were discussing with Mr. Boyle, obviously, the farm price and the wholesale price track each other as they go up and down. As they are

tracking, their spreads are increasing over time. Thus, your data is really consistent. It is USDA data.

The spread, it is hard to see it on that graph because it is such a wide graph, and it is more focused visually for tracking parallels. The spread has increased 50 percent farm to wholesale in beef and pork in the last 10 years. That is true.

The CHAIRMAN. My time is up. Senator Lugar.

Senator LUGAR. Mr. Chairman, clearly, there are different intensities of feeling about this problem in different States. In visiting with pork producers in Indiana, our president preferred not to testify today because of a division among pork producers not only on the bill we are talking about, but on the general marketing situations.

That has generally been true of cow producers in our State. There clearly is confusion as to where the best interest to the producer lies and what kind of arrangements would make a difference.

Now, we had testimony before our committee in the last couple of years suggesting that through co-ops producers might band together to have larger numbers and thus greater bargaining power. That is one of the things that has evolved, unfortunately, in America is fewer stockyards and fewer places where people are likely to have bids.

My grandfather and my father were involved in the Indianapolis stockyards. One sold cows, the other sold hogs. This was their livelihood and our livelihood. That yard is no longer exists. There is an Eli Lilly plant over that situation. We have been trying to create stockyards in various parts of the State so there might be other bidders.

The question, I suppose, is a broader one, and that is how is the buying and selling in livestock to be organized in America, or how do we encourage some outlets that are different from the situation we now have, which clearly is more concentrated?

I don't know that there is a good answer to that. As I have said, the co-op idea was an original one. The other idea that usually comes from this testimony is that everybody wishes there were more bids, there were more stockyards, there were more outlets. Indeed, we all do. Exactly who in America is going to produce these?

The ban on ownership is an interesting idea and maybe has some effect at the margin, but I suspect is not an answer to how competition occurs. I appreciate the testimony. I have listened carefully to this hearing, as I have to each of several in the last 10 years of time.

As I recall, hardly a year has passed without one of these hearings and sometimes two. My guess is that essentially we are seeing still more concentration as has occurred in other protein areas has been noted, despite the fact that we are still searching for the competitive model. I just simply appreciate the witnesses offering, once again, timely testimony as to where the market is.

Mr. JUNGCLAUS. Mr. Lugar, I would like to address that just briefly.

Senator LUGAR. Yes, sir.

Mr. JUNGCLAUS. You know, you indicated a definite situation out there, where we have buying stations that are on the countryside

that are just disappearing. In the case of if we develop a more competitive market, where are we going to put these buying stations? They are just not there. Well, they are still there. It is just that they are not being used in many cases.

It is important to note that I think if we look at opening our markets and making them fair and competitive—if we had an electronic market where all the contracts offered to producers out there, where every producer could bid on that market—the buying stations will take care of themselves.

When there is a need, the need gets filled. I mean, that would be a tremendous economic opportunity. Right away, you see increase in rural economy expansion by hiring these people to run these buying stations and different things like that. You can see how this packer ban on livestock and opening up these markets can really fuel the rural economy. That is just one very small example of that.

Senator LUGAR. Yes, well, I would really like to explore more the electronic idea. There is merit in that. It implies, however, that there are competitors, that there are people wanting to come into this business to bid, or people who are prepared at least to have a more open bidding situation as opposed to contractual arrangements with producers, and producers who are prepared to have the electronic thing as opposed to a deal that they have come into with a packer or with stockyards.

As I just observed, in my State, a lot of people have contracts, and they like that idea. They are perfectly satisfied. They listen to a hearing like this and say, “Well, that is too bad you folks don’t have the kinds of contracts we have. As a matter of fact, we are doing well.”

I just get back to the fact that there has to be some rationalization for why more competition occurs, more competitors, why do people want to get into this business? It does not appear to have been a promising business for people to invest money into, and I would guess this is one reason why there has been some contraction of competitors.

Mr. JUNGCLAUS. Well, some of the problem is that these contracts aren’t offered to every producer. I mean, that is a big issue. I mean, there is a lot of contracts out there that are offered to just the biggest producers. A lot of times, those contracts have basically gag orders in them, saying the details of those contracts can’t be released. Is that a competitive open market? I don’t think so.

Mr. BOYLE. Senator Lugar, I would suggest that packers did not withdraw over a period of time, more so on the hog side than on the cattle side, from auction markets, from fear of competitive bidding or an attempt to pay lower prices through contracts.

They actually withdrew from those auction markets because they needed the ability to control the quality and the type of hogs that they were buying because we were moving toward branded product, value-added product, more consistent, more uniform product, and we could not meet the demands of our customers, the demands of the marketplace buying random hogs that were not necessarily uniform through an open market.

We reverted or evolved to contractual arrangements. It wasn’t anything anti-competitive or a fear of paying higher prices. I would

also suggest that these contracts are mutually executed, and the hog producers who are in contracts, covering about eight out of 10 hogs today that make their way to market, are there because they have made a business decision that they can make more money through a contract than they were able to make on the open auction system.

There is nothing evil or nefarious. It is just the way the competitive nature of the industry has evolved and the demands that our customers are placing upon us to supply certain kinds of products.

Mr. STUMO. Mr. Chairman.

The CHAIRMAN. Yes, I am going to turn to Senator Dayton now.

Senator DAYTON. Thank you, Mr. Chairman. Senator Wellstone, my colleague from Minnesota, had to go to another hearing, so he asked me to ask a question on both of our behalf. The intelligent questions are from me, and if there are any unintelligent questions, those are Senator Wellstone's.

[Laughter.]

Senator DAYTON. Mr. Boyle, I appreciate you being here and having a different view. That is common, and it is a complicated subject. Obviously, different people in different sectors of the industry have different perspectives. I don't disagree with what you just said. In fact, I would agree that if we have a truly competitive market, where we have competitive buyers, people can then enter into willing contracts showing interest.

The concerns comes when there are not the options available through concentration in the industry. Individual producers don't have those other alternatives. Then, it doesn't become an equal relationship. If I go back to those charts that you presented there, and those were useful, and also reference your testimony in terms of the percent of the income that Americans are paying for their meat. That is certainly one important perspective, and one that all of us need to be aware of.

The flip side of that coin then is, though, what are the prices that producers are getting for their products? I am concerned and I think this committee has been prompted in part by especially in the hog markets just the devastating decline in prices. You know, in 1975, according to USDA, hogs were \$46 per hundred pounds. Then, they got as high as \$51, \$52 in 1996 and 1997. Then, as others have noted, they just plummeted down to average \$34 in 1998, \$30 in 1999. Last year, at least in Minnesota, they were \$45.80, and in June of this year, they were down to \$35.90.

That kind of fluctuation and going in the wrong direction is what is really driving our concern about the concentration and to what extent that does affect these plummeting prices. Now cattle have been more stable over time. Also, if I look at your charts, I see that in the cattle industry, it seems that a higher percentage of the value is going to the producer rather than the rest of the way down the line. Whereas the hogs, I am struck by both the amount of the overall price that is going to people other than the producer or the packer.

I believe I came to the same conclusion you did, Mr. Stumo, that it looked to me like in the last few years that the margin has improved for the packer. I wanted to ask you about the fluctuation in prices over these last few years because you cited, and I would

have thought, too, that one advantage of a contractual arrangement would be less price fluctuation for the producer. It seems on that chart that there has been more fluctuation in the last 5 years than there were in the previous 8 years.

Mr. BOYLE. Those are some excellent observations and a very good question, Senator Dayton. One of the primary reasons that the packers and producers, particularly on the hog side, have moved rapidly over the last 5 years toward either vertical integration, where the packer actually owns the hogs, or the more common model where the packer contracts with the producer for the hogs has been because of the volatility in the spot market.

There are other reasons as well, but that is one of the reasons. Many producers, in order to get the loans that they need to finance their operations during the grow-out of the animal, will require some contractual arrangement with the packer.

From my packers' perspective, this volatility makes it very difficult for us to manage our business as well. We don't have the ability to pass the volatile price changes onto our retail customers because they want a constant price, whether they are in grocery stores or restaurants. It is difficult for us to pass that volatility on.

At a time when, like 1996, when hog prices per hundredweight actually exceeded cattle prices per hundredweight, that is a huge amount of loss that we were having to sustain. At that point in time, two or three pork packing houses actually were forced out of the market because they couldn't sustain the losses that they were incurring.

Conversely, 2 years later, prices went from above \$60 a hundredweight to below \$10 a hundredweight. It was that dramatic fluctuation, where the packers were losing money in 1996 and the producers were hemorrhaging money in 1998, that brought them both together, under pressure from lenders, in order to have contracts that are based on spot markets that pay a little bit more than spot markets but also insulate producers from the extreme low prices and packers from the extreme high prices.

The producer base survived basically intact during that terrible fourth quarter of 1998. Many producers were forced out of business, but the production base itself remained basically intact. One of the reasons is that while the spot market volatility continues and, at that point, was paying \$8 a hundredweight, producers were actually making break-even or more under the risk management/risk sharing contracts that they had with their packers.

Senator DAYTON. Thank you. We are constrained, both of us, by the time here. I am sorry I can't pursue that with you. May I have one more question, Mr. Chairman? Thank you very much.

Mr. Jungclaus, I appreciate your being here on behalf of Minnesota. Other than the fact that your high school team defeated my son's team in a critical game last year, we have a lot in common. No, thank you for your excellent testimony and representing Minnesota so well on this panel.

I wanted to ask you in terms of your own—getting away from antibiotics, and creating a sense, I assume, a different product in the marketplace. Has that affected your price, improved the price that you receive or reduced the fluctuations?

Mr. JUNGCLAUS. It does improve the price I receive as far as when I sell animals directly to consumers. When I sell that product to Hormel or Smithfield or whoever, I don't get a benefit from that.

Senator DAYTON. OK, thank you. One question then just for any of the four of you, and I would ask you to be brief because we are out of time. In terms of this antibiotics and the use thereof, it seems that is one of the trends in the industry is increased use of antibiotics. Now we are talking about irradiation of meat. Do you see those as correlated with the pricing and the concentration, or is that a separate phenomenon?

Mr. JUNGCLAUS. It is very related. I mean, obviously, if you have 20,000 pigs in one building and you have a disease outbreak, you are in big trouble. When you are looking at operations that are very large, if you were to go antibiotic free, it would almost be like a death sentence for all those hogs and for that operation.

In a situation like that, they basically need antibiotics in that system or it would be devastating to them. That is where the small producer has a lot more versatility and can allow the consumer a lot more versatility.

You know, Mr. Boyle indicated that this whole process of vertical integration is driven by the consumer. I find that interesting because one of the biggest increases in consumer demand is for the antibiotic-free pork and organic pork and those kind of products. Yet, that is not the product that the large packer is putting out. It is the product that comes from small packing houses that is really increasing in demand. I found that as an interesting statement.

I mean, really, when we are looking at this vertical integration, we are looking at losing a lot of small producers that have the types of products that consumers want today. It would be a very convenient excuse to say that consumer wants this kind of cardboard pork products that tend to come out of the large packing houses, in my concern, anyway. Because that is not what the consumer wants.

The consumer wants taste and aroma and those kind of things that make eating food an experience? That is just not what I see the industry putting out right now.

Senator DAYTON. Thank you, Mr. Jungclaus. I am sorry I have to leave to go back and meet with a group of Minnesotans. I apologize. Thank you all for excellent testimony.

The CHAIRMAN. OK, thank you very much to this panel. We thank you for being here. We thank you for your testimony.

The CHAIRMAN. Now we call our second panel: Dr. Robert Taylor, professor at Auburn University in Alabama; Mr. Herman Schumacher, R-CALF USA, from Herreid, South Dakota; Mr. Paul Jackson, National Farmers Union, Oklahoma City, Oklahoma; Mr. Eric Davis, the National Cattlemen's Beef Association president-elect, from Bruneau, Idaho; and Mr. John Butler, CEO of Ranchers Renaissance, Englewood, Colorado.

We welcome you all here again, and your statements will be made a part of the record in their entirety. We would ask again if you would summarize in 5 minutes. We would start, of course, first with Dr. Robert Taylor, professor at Auburn University in Auburn, Alabama. Dr. Taylor.

**STATEMENT ROBERT TAYLOR, PROFESSOR AT AUBURN  
UNIVERSITY, AUBURN, ALABAMA**

Mr. TAYLOR. Thank you, Mr. Chairman and members for the committee. I appreciate this opportunity to testify on important issues in the livestock industry.

I will get right to the point. There have, indeed, been efficiency gains in the meat industry. There have been quality improvements. At the same time, there is compelling evidence that buyer power, technically called monopsony power, and seller power, called monopoly power, have been exerted in the markets for beef and pork.

In my written testimony, I have several charts. All of those charts are corrected for inflation. That is the only way to do it. Most of them present USDA statistics corrected for inflation.

The retail price for beef over the past 20 years has declined dramatically. Part of that is due to the inflation-adjusted price of feed going down. In fact, about two-thirds of the decrease in the real retail price for beef is due to lower feed cost, not to efficiency gains in meat packing or production.

The farm to wholesale spread measures gross revenue to meat packers. Adjusted for inflation, going back to the 1980's, it declined substantially. That is consistent with efficiency gains in a competitive market. In the mid 1990's, it started turning up, and it turned up dramatically and, in the last 6 or 7 years, has increased about 50 percent for both beef and pork. That is a sign that buyer power is being exerted. There is no alternative plausible explanation for it, except market power being exerted.

The wholesale to retail spread, which measures gross revenue to the meat retailers was fairly steady for that 20-year period. About a year ago, it shot up dramatically to all-time highs. The farm to retail spread declined during the 1980's due to the efficiency gains in meat packing. Most of those efficiency gains have been lost due to exertion of buyer and seller power in beef markets. That has turned back up, and the farm to retail spread is almost as high as it was in 1980.

Income for feeding cattle, adjusted for inflation, has had a strong downward trend for 20 years. In the 1980's, returns to finishing cattle in Kansas averaged about \$40. For the last 10 years, they have averaged a negative \$15 based on market prices.

Some cattle feeders are making money because they are more efficient, and some are making money because there are preferential deals out there, and they get a better deal than the independents. That is a hidden or overlooked conclusion in some of the GIPSA studies that have been mentioned.

Independents are losing money, while some of those with the preferential deals are making money in cattle feeding. In Economics 101, when you offer a preferential deal to some, that increases aggregate supply, lowers cash price. Simple economics.

The ban on packer ownership is not the only change needed to re-establish competition in the meat markets. There is the issue of preferential treatment that I just mentioned that is not fair. Bidding practices need to be changed. It was mentioned earlier about in the cattle industry, some feeders have only 5 minutes to accept or reject an offer, and that is the only one they will get for a week

or more. That does not give them long enough to go out and solicit competitive bids.

Having contracted supplies tied to a cash market price or to a futures market price is problematic. If a marketing agreement is tied to a cash market price in which the contractor is actively participating, that gives him a tremendous incentive to manipulate price. It is a multiplier incentive. They don't gain just on what they buy on the cash market. They gain on all of the contracted supplies. That incentive needs to be eliminated.

We need true mandatory reporting. In economics jargon, there is a problem with asymmetric information, and that is what we have now. The packers and some of the large industry participants have more information than the independents and the smaller ones, and they can use that information to their advantage. Everybody needs the same set of information, and they need it in a timely way.

Finally, partial vertical integration is problematic. Partial vertical integration, which is what we have in the beef and pork industries is problematic because packers may use it to transfer risk to the market. You get thinner markets and more variable markets, and we have certainly seen that in the hog industry.

The issues and the industry are highly complex, and there is no simple solution. These are issues I think need to be addressed. If we need a study at all, it is a very careful one on electronic markets and whether we could use that to re-establish competition.

Thank you.

[The prepared statement of Mr. Taylor can be found in the appendix on page 110.]

Senator LINCOLN [presiding]. Thank you, Dr. Taylor. As you all have noticed, there has been a change here. The chairman had to excuse himself. I am back and delighted to be.

Mr. Schumacher, I think the majority leader gave you quite an introduction earlier that you will offer us great and valued information. We are all prepared to hear that testimony.

**STATEMENT OF HERMAN SCHUMACHER, R-CALF USA,  
HERREID, SOUTH DAKOTA**

Mr. SCHUMACHER. Thank you, Senator Lincoln.

Senator LINCOLN. Thank you.

Mr. SCHUMACHER. Senator Lugar, this is the fifth time I have done this, testifying in front of the Senate Ag Committee, and also in 1996, I was on a commission on concentration in agriculture.

I am here today representing the Cattlemen's Action Legal Fund. It is known as the United Stockgrowers of America, R-CALF USA. I am a director of R-CALF USA, and I represent the States of North Dakota, South Dakota, Nebraska.

I am also a cow/calf producer, a feedlot operator, owner and operator of the Herreid Livestock Auction in Herreid, South Dakota. I am also an auctioneer. An auctioneer likes to talk a long time.

[Laughter.]

R-CALF's mission is limited to representing the U.S. live cattle industry in trade and marketing issues to ensure the continued profitability and viability of the U.S. cattle producers. In 1999, less than 3 years ago, R-CALF USA moved from a foundation to a national membership organization and is now the fastest-growing

U.S. cattle association in America, with 1,100 new members since the first of the year.

We now have a national membership of over 6,000 producers in 42 States. We also have 30 affiliated organizations, including 10 State-wide cattle associations, 18 county cattle associations, and two big general farm associations. Our association's rapid growth is a direct reflection of the growing concern among U.S. cattle producers for the chronic and severe problem associated with our cattle markets.

I commend Chairman Harkin and the rest of the committee for holding this hearing today. As evidenced by the many individual and joint association letters received by this committee, cattle producers all across America greatly appreciate the Senate's earlier passage of Senator Johnson's packer ownership ban. Cattle producers also appreciate the chairman's leadership in working to include the Competition Title in the recent Farm bill.

I am pleased to address the proposal to ban packer ownership of livestock and USDA enforcement of the Packers and Stockyards Act. Much has been said today about the market share beef has lost to competing meats. However, the most damaging lost market share cattle producers suffer today is the lost share of the consumers' beef dollar from the packer and retailer.

According to the respected Doane's Ag Report on October 26, 2001, the farm to retail spread has topped \$1.90 a pound. If the spread were in line with normal, current retail prices would translate to live cattle prices in the mid 80's rather than in the very low 60's.

Winter Feed Yards in Dodge City, Kansas, reported in December of 2001, as of November 30th of 2001, that retail beef prices were 9 percent above a year ago. Now remember, December 2001 was after 9/11. Fed cattle prices—we got hurt by 9/11—were 19 percent below 1 year ago.

It is important to note that there are two functioning production models within the U.S. meat industry. The first model represents the U.S. poultry industry.

As stated in the Sparks study commissioned by the National Cattlemen's Beef Association and the National Pork Producers Council, "Over time, these independent poultry business, including independent feed mills, hatcheries, farms, and processors, were combined by integrators who reduced costs by coordinating the production of each stage. As a result, an industry once characterized by tens of thousands of small, specialized businesses became characterized by hundreds of vertically integrated firms." Through horizontal integration, however, the number today is around 50.

It is highly questionable whether chicken producers have benefited from this level of integration. In the poultry production model, competitive market signals no longer reach the producer as the integrator dictates both the terms of production and the price for live birds. Having served on this commission in 1996 with a poultry producer, she said, "They have the live birds. We get the dead ones."

The second model is represented by the U.S. cattle industry. Here, the production system is characterized by a million independent cattle feeders and cattle producers. When cattle markets func-

tion properly, consumer-driven supply/demand determines both the terms of production and price for cattle.

Today, our cattle markets are not functioning properly. Instead, the economic power exerted by the highly concentrated beef processing industry upon the live cattle industry is becoming alarmingly similar to the poultry model I just described.

Mr. Chairman and members of the committee, I am here to tell you that both sides of the packer ownership ban issue can draw upon economic studies to support their position. The beef industry, as indicated by the NCBA and NPPC's Sparks study is well under way to vertically integrate the feeding sector with the already integrated processing sector. If this is allowed to continue, the outcome will be just like the poultry model. Fed cattle prices will be determined not by competitive market signals, but rather by the integrators.

Again, the Sparks study admits that this outcome when it states, "Vertical integration often attracts investors because of the negative correlation between profit margins at the packing stage and the feeding stage."

The risks that feeding margins may become higher and packer margins lower are the very risks that the Sparks study says packers should control through captive supply. The study states, "Thus, efforts to control risk are one of the most important drivers of increased vertical integration and coordination."

Attached to my testimony is a chart showing the relationship between retail beef prices and live cattle prices since 1979. This chart shows that until 1994, our industry had more confidence.

The second issue is that the USDA enforce the Packers and Stockyards Act. GIPSA was referenced in the March 2002 GAO study indicating as far back as 1996—this is a GAO study just completed in March—GIPSA could not conclude that the cattle industry was competitive yet. GIPSA is the agency guarding against unfair anti-competitive practice.

Importantly, consumers are equally harmed by inaction as they have not realized any economic savings from the significant lower prices for cattle. In the months of April and May of 2000, a record-breaking production year, choice retail beef was \$3.07 per pound, and fed cattle were \$72 dollars. During the same period this year, production is down 2 percent from 2000, choice retail prices are \$3.30. Fed cattle are in the low 60's.

I will tell you what, U.S. cattle producers—I will wrap this up as soon as I can.

Senator LINCOLN. You can wrap it up, but absolutely your entire testimony will be included.

Mr. SCHUMACHER. OK. U.S. cattle producers have become so frustrated with USDA's inaction that many are seeking relief from the judicial branch of government. I am a plaintiff in the pending class-action suit *Picket v. IBP*.

I am also involved in the recent class-action lawsuit stemming from USDA's misreporting of boxed beef prices last April and May. While USDA was misreporting boxed beef prices, all four of the major packers kept bidding artificially low prices for live cattle. We believe the packers who were selling the boxed beef were fully

aware, and if not their banker was, what USDA's mistake was. Yet they continued to underbid for cattle.

As soon as the mistake was publicly announced, live cattle prices jumped \$2 to \$4. U.S. feeders, backgrounders, cow/calf producers all lost a ton of money selling into an artificially low market like that.

Producers in South Dakota, Nebraska, and many other States are suffering from severe drought. My father weathered droughts in the Dakotas because we had a competitive market in which to recover a fair value for our market.

The last severe drought we went through in our State was in 1988. We called our cows. They brought \$50 a hundred. Retail prices were \$250 a hundred. In today's drought, we are selling cows, butcher cows at \$35 a hundred. Retail price \$331.

In closing, I would just like to say that all of America, as well as myself, appreciates the very fast and appropriate action the Senate has taken on the very inappropriate and downright unlawful actions that some of our corporations in America have taken. You must all understand that cattlemen have been suffering the same kind of mistreatment by the meat processors for many years. Like the people of America who have been cheated out of their retirements and life savings, I want you to all know that the treatment by the meat packers today is no different.

Our farmers and ranchers are losing their entire livelihoods. We are losing our schools, our business, as well as our churches all at the hands of the meat packer. Like we witnessed the corporate CEOs of WorldCom and Enron who walked away with millions of bonuses, the big four packers are doing the same. Just recently at an NCBA convention, President Bush stated and let me quote the president—

Senator LINCOLN. Mr. Schumacher, if you could wrap that up?

Mr. SCHUMACHER. —“I realize there is nobody more central to American experience than the cowboy. Cattle raising is not only a big part of the American past, I view it as an incredibly important part of the American future.”

Well, Senators and President Bush, if the market structure does not change, the American cowboy will be of the past. Thank you for your consideration.

[The prepared statement of Mr. Schumacher can be found in the appendix on page 125.]

Senator LINCOLN. Thank you, Mr. Schumacher.

Mr. Jackson, we welcome your testimony.

**STATEMENT OF PAUL JACKSON, NATIONAL FARMERS UNION,  
OKLAHOMA CITY, OKLAHOMA**

Mr. JACKSON. Thank you, Senator. Members of the committee, I am delighted to be here on behalf of Oklahoma Farmers Union and National Farmers Union. I am Paul Jackson, a fourth-generation agriculture producer from south central Oklahoma. With me today is my wife, Kim, and our daughter Courtney.

Senator LINCOLN. Well, welcome to your family. We are always glad to have them.

Mr. JACKSON. I farm and ranch with my father and brother. Our operation includes 3,000 acres of mostly rented land, 200 cow/calf

pairs, and about 1,800 stockers per year that is purchased from local auction barns.

I want to commend the committee, the chairman, for the recently enacted Farm bill. Particularly, I want to thank you for including the mandatory country of origin labeling. This is a big win for U.S. beef producers as well as consumers across this country.

The Farm bill will help relieve symptoms of the economic distress in the countryside, but it cannot stop the hemorrhaging. The economic health and vitality of independent producers and rural communities depends on reviving competition and transparency in the marketplace. The ban on packer ownership of livestock is critical. The market influence of the packers is tremendous.

Packer ownership and captive supplies allow packers to stay out of markets at strategic times to influence the prices paid for open market cattle. To this extent, packers prefer their company-owned supplies over that of independent producers. Those cattlemen have far less access to markets. The 2000 cattle price crash essentially resulted in my working an entire year for nothing and adding debt. This is very frustrating when, at the same time, packers make record profits at our expense.

The spring market slide has been linked to an array of issues, including the false report of the foot and mouth disease case and a British woman diagnosed with Creutzfeldt-Jakob's disease. While these events may have contributed to market downward fluctuations, the slide began on February the 19th. We received active bids from buyers on our farm through Monday, February the 18th, Presidents Day. The following day, the market opened down and proceeded to plunge. Little to no interest was given in purchasing cattle unless we gave them away.

When inquiring about the lack of interest compared to that demonstrated by cattle bidders in the previous week, one bidder replied that buyers were staying out of the market because of the packer ban amendment pending in the Farm bill conference committee. We continued to hold our cattle, hoping for a price recovery, but costing us each day. After finally selling the cattle, I cleared my note for the purchase of the stocker cattle. However, I lost all other input costs related to my cattle operation, leaving me in the hole this year \$50,000.

After deducting the cattle costs, the interest, the additional feed cost, and vet supplies, the end result was \$30 per head, leaving us little to service the general operating debt. It was a far cry from the \$100 average annual projection of return. There was and is a slaughter, but it does not involve cattle. It involves the equity and elimination of producers.

I cannot provide you hard data there was concerted effort by packers to drive cattle prices down in order to eliminate the packer ban provision. The circumstances strongly suggest that this was more than an isolated market event. It is the evidence of the need for the very legislation the packers were trying to eliminate.

Packers doubly triumphed. They defeated the packer ban provision, disadvantaging producers and consumers, and then scored gains on their ledger sheets by taking advantage of the lower cattle purchase cost without a corresponding reduction in retail prices.

What action is needed? Passage of the ban on packer ownership of livestock. This legislation should be the top priority in helping to improve market performance, increase competition, and enhance market access and opportunity for livestock producers. No more studies are needed. Producers will not benefit from more economic or academic studies. Every day we wait, the situation becomes worse in the countryside. The time for studying is past. It is time for action.

Congress must address the issue of captive supplies. We recommend legislation that places restrictions on the percentage of captive supply. A processor may have and require that firm bid pricing be established in forward contracts. We need passage of the Competition Title in its entirety. A key provision in the Competition Title creates within USDA an office of special counsel for competition.

The special counsel should aggressively investigate anti-competitive practices and market manipulation occurring in the ag sector. It should have the authority and the subpoena power to collect concentration-related information. It should be able to seek outside counsel when conducting complex competition litigation. The Justice Department already exercises this authority.

Congress must modernize the Packers and Stockyards Act to work in today's cattle market to provide real protection to farmers, ranchers, and poultry growers. The legislation is over 80 years old now, and we don't market the same way as we did back then. Congress must require USDA to modernize its data and models to accurately reflect today's beef industry.

The recent GAO report that has been noted today identifies that USDA has not revised its models in over a decade, even though much of the data used predates the rapid rise in concentration.

In closing, livestock producers, better than anyone, know how to produce a top-quality type cattle. They require open, transparent, and competitive markets to benefit from their production. I once heard a minister say that as long as there is life, there is hope. The hope is fading, and so is the very lifeblood of the family cattleman.

My grandfather used to say that as long as you hold onto the cow and the old cow's tail, she would drag you through the tough times. Well, I am here to tell you today that that tail is a nub, and we are slipping fast.

I want to say thank you to the committee, Senator Lincoln, Senator Lugar, and the chairman for holding this hearing today. Thank you.

[The prepared statement of Mr. Jackson can be found in the appendix on page 139.]

Senator LINCOLN. Thank you, Mr. Jackson. As a neighbor to my west there in Oklahoma and myself coming from a seventh-generation Arkansas farm family, I completely understand both your passion as well as your interest in this issue because it is not just for you, it is for your children and generations to follow. We appreciate you very much.

Mr. Davis.

**STATEMENT OF ERIC DAVIS, NATIONAL CATTLEMEN'S BEEF  
ASSOCIATION PRESIDENT-ELECT, BRUNEAU, IDAHO**

Mr. DAVIS. Thank you, Senator Lincoln. How do I refer to you right now, Madam Chairman or Senator Lincoln.

Senator LINCOLN. It doesn't matter.

Mr. DAVIS. OK.

Senator LINCOLN. Senator Lincoln or Madam Chairman, either one is fine.

Mr. DAVIS. OK, thank you. Thank you, Senator Lugar, and thank you to Chairman Harkin for holding this hearing.

My name is Eric Davis. I am a cow/calf feeder, farmer, operator, president of a family corporation in Bruneau, Idaho. That is in the southwest corner of the State. I am here today representing as the president-elect and representing the National Cattlemen's Beef Association.

You have heard a lot of testimony today, and I think it indicates that there is certainly great disparity of opinion within the beef industry and the total meat industry about what the best direction to go is. I will try to be very brief in my comments. I can't read my testimony in 5 minutes, so I will try to shorten it up and still hit the high points.

One thing that hasn't been brought up and it has been alluded to a time or two, but there are some fundamentals that still play a role in this marketplace, and we can't forget them. We do have increased production in all sectors of the meat industry this year over last. Yes, we do have fewer cattle, and we have higher retail prices. Production is also expected to be a record high this year and has been bigger for the first half of the year than expected and than it was a year ago.

We have to keep that in mind, too, that there are still some fundamentals functioning in this marketplace. At the same time, our membership recognizes that historic price relationships from farm to wholesale to retail have changed in the past few years. No matter what price model you use, you can see that there have been shifts in the fundamental relationships. We need to find out what has truly caused those.

NCBA has historically preferred a market forces approach to government legislation and regulation, but we have not ever hesitated to initiate legislation or regulations to move the beef industry forward. For example, our predecessor organizations were part of who pushed for the Packers and Stockyards passage in 1921.

We have been behind the implementation of HACCP on inspections. We supported mandatory price reporting. We support the Beef Promotion and Research Act. Those are just a few examples of where we recognize there is a partnership with government involved in our business as well.

We also recognize that we have a responsibility as an industry organization to try to provide options to our members in ways to attain profitability in other than the more traditional way of the cash market. We currently have a think-tank working. That may be a term that a lot of people don't like, but there are alternative indices for negotiating price and value that we are looking at now as a result of the mandatory price reporting law.

AMS intends to come last month, and I hope it is very soon, with a composite Boxed Beef Cutout that could very well be used as a negotiating point on formulas and grids. If the industry accepts it as a firm number, I see that as being another place to actually negotiate the base value of those formulas and grids and not have to rely solely on the cash market. Not to replace the cash market, but to be an alternative to it for those it may work for.

We need improved risk management tools, and we are working with CME on the current contracts, how to improve them. Also looking toward the future for the next generation contract that may be a better risk management tool than the ones we have today.

We agree that we need to, as an industry and as a Congress, strengthen the packers and stockyards resolve to give them the tools they need to fully enforce those things they are charged with enforcing, as Mr. Hawks spoke about this morning.

We support the formation of a dealer trust. We desperately want a uniform definition of captive supply between AMS and GIPSA, and we have a recommendation for what that would be. We support the implementation of the GAO and OIG recommendations, and we agree that the whole Packers and Stockyards Act probably needs some modernization, just as the previous speaker indicated.

Long term, I know this isn't popular here today with all of the witnesses, but our membership says we do need a good study by an outside business school that looks at the total protein complex as well as the beef industry and how the fundamentals have changed and appear to be going to change in the near future, so that we can better position ourselves in the direction that we take.

I am not suggesting that everything stop and be in a vacuum in the meantime because it won't. There are things happening that I have already alluded to that will help move this industry forward, maybe not as quickly as any of us would like, but I would beseech the committee that to move deliberately with careful consideration of the facts as best we can find them and to avoid those unforeseen consequences that we have seen before.

We need to remember that beef doesn't have a price safety net. We can't afford to make a mistake, and I suspect, if anything, I have learned here today is that the ban on packer ownership is much more complex issue and not the simple answer that some would suspect that it is. I have to disagree with those who think that is the only answer. I ask you to be careful in your consideration.

Thank you.

[The prepared statement of Mr. Davis can be found in the appendix on page 146.]

Senator LINCOLN. Thank you, Mr. Davis. We appreciate your testimony.

Mr. Butler, you will wrap up our testimony. Just to reassure all of you all, your entire statements will be included in the committee's record. I want to make sure you are aware of that.

**STATEMENT OF JOHN BUTLER, PRESIDENT AND CEO,  
RANCHERS RENAISSANCE, ENGLEWOOD, COLORADO**

Mr. BUTLER. Thank you, Senator Lincoln. My name is John Butler, and I am president and CEO of a cattle marketing cooperative

entitled Ranchers Renaissance. I represent beef producers who are involved in every segment of beef production, ranging from ranching, feed yard management, feed yard ownership, marketing, and marketing of branded beef. I also am a cattle producer myself.

I am here today to briefly explain to you an initiative that was created by producers 6 years ago to address the fundamental problems associated with commodity beef marketing system. In 1997, a meeting initiated by a group of beef industry leaders was held to address key marketing problems facing the ranching community. They agreed that it would be necessary to have a common focus to effectively address concerns related to the flawed commodity pricing and marketing system. They agreed the focus should be driven by consumers and that the consumer would embrace a branded beef product that would deliver on a promise.

It was also agreed that this consistent process would require a steady supply of predictable cattle to fill the products of a branded line. In addition, being fairly rewarded for producing value based on consumer demand was a priority. From this initial meeting, it was obvious that developing partnerships that cross over from one segment to the other in the beef-producing value chain would be the solution to pursue.

The result of these discussions was Ranchers Renaissance. Ranchers Renaissance was conceived as a vertically coordinated cattle marketing cooperative. Our mission is to be a customer-focused, high-quality, integrated beef production system with profits derived from increased efficiency and consistent value-added finished products. Ranchers Renaissance is an example of how producers and packers can work together to regain precious market share and, most importantly, sustain long-term profitability.

Removing any participant from this system dramatically and negatively affects those remaining. Ranchers Renaissance membership consists of ranches, feed yards, and a packer/processor. Our cooperative was designed for large and small operators willing to adopt our vision. We have ranches located from Florida to Hawaii. Our feed yards are privately owned and range in size from 12,000 head one-time capacity to 45,000 head one-time capacity.

After 5 years of working with these producers, I can assure you that they have at least two things in common: one, tremendously independent and, two, a passionate commitment to this vision. We have created a systems approach to beef production. The system we have implemented is a series of validated production and best management practices that result in a higher quality, more consistent product.

The next step in our process was to merchandise our efforts to an end-user and to develop economic drivers to reward producers for creating value in a product that the consumer demands. We have done so and have now become a critical supplier to the brand known as Cattlemen's Collection, which is now being merchandised as the entire fresh meat case in over 350 Kroger stores in the Atlanta market and in the Colorado market.

In the last year, the consumer has changed buying behavior in these markets and actually purchased more beef products. In addition, the consumer is gaining brand recognition as well as brand loyalty. We are now in the process of expanding this program into

additional regions throughout the country. It is important for you to appreciate that the ultimate value in our branded product is a result of synergy between segments.

As an example, the ranchers add value by using the right genetics, best management practices, and produce a healthy calf to be nominated to the Ranchers Renaissance cooperative. The feed yard members add value by managing the cattle in a process-verified manner. Our packer/processor adds value by disassembling and fabricating these animals to ensure a timely delivery of beef products to our end-user as well as utilizing their expertise in marketing and merchandising our beef to meet the brand criteria is a very critical responsibility of our packer partner.

Shared risk and reward. Traditionally, if a rancher manages an animal from start to finish, he assumes virtually all risk. Virtually everybody I have heard on the panel today would agree with that. In our opinion, we have created a financial model that actually shares risk between segments.

Reward. The beef industry and, ultimately, the American consumer have suffered because the commodity cattle marketing system, a system that does not send clear economic signals relative to value, traditionally poor quality cattle are unfairly rewarded as they have been accounted for in the average. At the same time, higher quality cattle have not been adequately rewarded for the same reason. This commodity system has resulted in a very inconsistent product for the consumer.

In fact, research indicates that one in four eating experiences of commodity beef is unacceptable for the consumer. Our system has been designed to recognize value, reward those responsible for the creation of this value, and provide the consumer an exceptional eating experience every time. The ban on packer ownership would create restrictions that would force us to dismantle what seems to be a very successful system.

In summary, there are volumes of consumer research that indicate that beef demand has halted its decline and, in fact, has turned the corner, is on the way up. A significant portion of this increase in demand has been the result of successful implementation of a number of branded programs which are now bringing more value to the consumer and, ultimately, the producer.

We have come a long way, and we have a long ways to go. I just caution this group and the committee as you look at potential restrictions that would change the way we are beginning to operate. You have heard from Eric Davis of the National Cattlemen's Beef Association. He mentioned the price discovery think-tank. We think that there are some very logical recommendations that are coming from this group. I wanted to ask the committee to give careful consideration to these recommendations.

Thank you for the opportunity to participate in this hearing, and I would be happy to answer any questions at this time.

[The prepared statement of Mr. Butler can be found in the appendix on page 168.]

Senator LINCOLN. Well, I would like to thank all of you gentlemen for your contribution today and your testimony. I am not only a Senator, but I also happen to be a farmer's daughter. I also happen to be a mother of two boys who like to eat beef and a husband

who does as well. I am probably one of the few on this committee that does an awful lot of grocery shopping.

[Laughter.]

I don't know that a whole lot of my colleagues spend as much time in the grocery store as I do. I would like to just direct a couple of questions, if I may, to this panel based on some of that.

The first being what interest do consumers have in the legislation such as the ban on packer ownership and the increased enforcement of the Packers and Stockyards Act? To what extent have the changes that we have seen in the beef market and the cattlemen's market have been driven by consumer demand? Anybody that might like to touch on either of those?

Mr. BUTLER. I would be happy to take a shot at that.

Senator LINCOLN. Sure.

Mr. BUTLER. I appreciate the question. Our little project was created out of demands coming from consumers. Consumers ultimately telling us that we, as a beef industry, are not supplying a product that meets the value equation.

Essentially, I think that the industry, and I am not the only one, there is a number of these alliances that have started up to meet that and to answer that question. That if we can deliver a more consistent product on a more consistent basis, we will be answering the ultimate question of the consumer and regain back precious market share that we have lost.

Mr. DAVIS. Likewise, Senator Lincoln, the long-range plan for the National Cattlemen's Beef Association has its eye on increasing demand by listening to the consumers express needs and desires and watching what happens in the marketplace. The problem we have today is that some of those fundamental relationships between the sectors have changed, and we need to know exactly what before we decide what the answer is to it.

Mr. SCHUMACHER. Senator Lincoln, the process of the way they buy cattle and every State is going to say they have the best cattle. I don't think we get many people to argue about the upper Midwest, where I am from, that we do have the best cattle. The problem is—

Senator LINCOLN. Now, I have a put a chime in there for the—

Mr. SCHUMACHER. For the Montanans. I am in Montana and the Dakotas.

Senator LINCOLN. Well, I am from Arkansas.

Mr. SCHUMACHER. Oh, OK. There we go.

Senator LINCOLN. We have the largest growing cattlemen's association out there.

Mr. SCHUMACHER. Yes. What we have there, Senator, is we have the buying of fat cattle today by the big three basically. It is simply they are bought on an average, you understand, in the cash. I trade about 30,000 cattle a year, fat cattle, to the packers.

As far as consumer driven, I can agree with that that there are consumer-driven products out there, but not to the benefit of the producer, if the producer is selling them into this type of predatory market. If you understand me, Senator.

Senator LINCOLN. I do. I have to say that when I buy my beef, there are two places I go. One is a very small, privately owned butcher shop in the middle of nowhere in Arkansas, and I have no

idea where he gets his beef because he won't tell me. The other is an extremely large wholesale grocery-type situation. That is where I have found the two most reliable products that I put in the freezer so I know what I have when I serve those three finicky men that I have at home.

Mr. SCHUMACHER. The label on it is, is it a branded product? It is a USDA prime, choice?

Senator LINCOLN. Well, it is USDA. It has to be, I am sure. Yes.

Mr. SCHUMACHER. Well, it is all—

Senator LINCOLN. I mean, I just know that those two people, those two places consistently carry the beef that I enjoy at home. Now, when I go other places, I am never quite sure. There are those two places.

Mr. SCHUMACHER. Now, just one more thing. You know, I sell, we sell about 160,000 cattle through our auction every year, and we have Caprock, which is a division of Cargill. We have ConAgra, which is Monfort, or I don't know what the connection is there no more. Monfort, or ConAgra sold part of the packing industry. They don't buy the top of the shelf of the cattle at our auction.

Senator LINCOLN. Well, anybody else have comments on that, the consumer perspective, either what interest does the consumer have or what impact do they have? I mean, that is—

Mr. JACKSON. Yes, Senator. It was kind of ironic that the very time that we were beginning to see these plunges, we were going to our meat market and talking to our meat manager. At the very time that we were seeing the market drop out of the bottom, he is telling us he has been notified of the latest price increase. There is no, I mean, there is no rhyme or reason or correlation there. The consumer, to me, benefits as much as the cow/calf guy out there.

Somewhere along the line, I lost \$70, and someone else got it this time. That is not to take away from the price that the cow/calf guy gets. On average, about \$100 per head on the stocker operation is about what we shoot for. Some years, we will get more than that, depending on what we bought the cattle for.

One thing I did want to just touch on just very quickly, one thing we have seen really change in the last year or so is those individual stocker producers out there that are going to livestock auction markets are now competing with the feeders, who, I suspect, has some interesting relationships with the packers.

Now we are competing against someone who is willing to pay a little bit more of a premium, and that is very difficult as well out there.

Senator LINCOLN. Well, just the last thing that I would ask also, and I know that we have dealt with this in my other committee a good bit. What changes, if any, have we really seen in the export markets of meat and poultry industries? I mean, is there anything you would like to comment there in terms of our export industries?

Mr. DAVIS. If I could?

Senator LINCOLN. Sure.

Mr. DAVIS. Depending on what timeframe you are looking at, but over the last 20 years, we have had great growth in exports. Over the last 6 months, it has been a little tough. It looks like we are going to come out ahead of last year again right now. The BSE scare in Japan hurt that market tremendously.

Senator LINCOLN. Right.

Mr. DAVIS. That is just looking at the beef portion of it. Of course, Mexico picked up, and it is now our biggest export market. One of the other things that has happened is the poultry problem with Russia.

Senator LINCOLN. Tell me about it.

Mr. DAVIS. Yes, I am sure I don't need to tell you. The number is 45 million pounds a week that is not leaving the country. That certainly is competition to the product that we produce. I hope we can get that fixed soon.

Senator LINCOLN. Mr. Schumacher.

Mr. SCHUMACHER. Senator, yes, with all this extra poultry around, we have seen retail beef, we are seeing it higher than a year ago. With 2 percent less production than we had in 2000. If you go back to my statement, in the year 2000, \$72 fat cattle. Today is \$60 fat cattle. Our production is less today than it was in 2000.

If you want to look at a picture right there. You understand what I am getting at? We are getting about \$170 a head less today for a fat steer or heifer than we did in 2000, when domestic production as well as imports were 2 percent higher than they are today.

Senator LINCOLN. Right.

Mr. SCHUMACHER. Today we are selling at \$60, and in essence retail is higher. The poultry argument just doesn't fetch because, I mean, competing meats, yes. Beef must be selling. It is bringing quite a price.

Mr. BUTLER. I might just comment on that, a point of clarification. We are producing an average of 35 pounds more per head today. Even though there are fewer cattle, as Mr. Schumacher pointed out, it is actually more red meat. The absolute truth of the matter is there is more out there, and that is a tremendous impact when you are bringing more total pounds to the marketplace on a market price.

Again, I am not trying to defend mine or any other, but when you can deliver on a promise consistently, there are more dollars to those that produce it. That is absolutely what we want to make sure is whatever restrictions are considered here, don't take that away. Don't take that freedom away from the cattle industry to have that opportunity to go build those systems to create their own value.

Mr. JACKSON. I would probably agree with that in terms of cattle being bigger out there, on the other hand, we continue to have a beef deficit in this country in imported beef. As we say back home, that dog won't hunt.

Senator LINCOLN. That is right.

[Laughter.]

Well, I want to thank all of you all for your input, and I think that this is certainly an issue that we did take up during the Farm bill, and we will continue to focus in on. If there is anything that is consistent among this table, it is that our producers here in this country are the most efficient and effective, and they have done an excellent job at that, and we want to continue to work with you so that we can maintain that.

Thank you very much for being here today. The committee will be adjourned.  
[Whereupon, at 1:10 p.m., the committee was adjourned.]



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**APPENDIX**

JULY 16, 2002

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Senator Pat Roberts  
Statement  
Senate Agriculture Committee  
Hearing on Packer-Ownership  
July 16, 2002  
SD-562



Mr. Chairman, Ranking Member Lugar, I thank you for bringing the committee together today to finally have a hearing on an issue that brought much debate to the Farm Bill along with much confusion to what legislation regarding packer-ownership actually would accomplish. I look forward to the informative views and opinions of the panelists at this morning's hearing.

While the large majority of the legislation referred to this committee carries good intentions, I am always watchful for the unintended consequences.

Consider the case of mandatory price reporting. Enacted into law as the Livestock Mandatory Price Reporting Act of 1999, this legislation was implemented in April of last year. Several weeks, a computer glitch, and \$15-25 million in losses to the industry later, mandatory price reporting had jumped out of the gate and fallen flat on its face. While understandably difficult to implement in the time frame mandated in the legislation, mandatory price reporting demonstrates the challenge of any legislation attempting to aid producers in the dynamic, and ever-changing cattle industry.

Mr. Chairman, I have argued for many years, that we need to give our producers every tool necessary to compete and that we should carry a big stick to ensure the packing industry treats producers fairly. Mergers and increasing concentration is not a phenomenon specific only to the livestock industry, it is also occurring in other sectors of agriculture, as well as in the banking, telecommunication, retail, insurance, manufacturing, health care, and pharmaceutical industries. I believe that we have the means to address these concerns within agriculture and feel that a better job of enforcing these laws needs to be done.

Kansans are proud of the beef industry and the history it has played in our state. From the days of the cattle drives that stretched from Texas to Abilene and Ellsworth it has been one

of our top industries.

Coming from Dodge City, I fully understand the concerns of those who are worried about the largest packers having control over the market. Prior to a devastating fire in late 2000 at the ConAgra beef division plant in Garden City, KS we had all four of the major meat packers doing business within a 100 mile radius of Dodge City.

While some argue that the packers have a crippling effect on the cattle market, I can tell you that the economy of western Kansas would not survive without the beef industry – individual producers, feeders, and packers.

How important is this industry to Kansas?

- Cattle represented 62.6% of the 2000 Kansas agricultural cash receipts.
- Cattle generated \$4.95 billion in cash receipts in 2000. More than double that generated by our second largest commodity – wheat.

Kansas:

- Processed 8.21 million head in 2000
- Grazes 1.5 million stockers annually
- And, had 1.52 million beef cattle in the state on January 1, 2001
- Kansas ranked first in commercial cattle processed in 2000.
- Kansas ranks second in the value of live animals and meat exported to other countries at \$969.7 million in 2000.
- Kansas ranked second in fed cattle marketed with 5.37 million in 2000, representing 22.3 percent of all cattle fed in the United States.
- Kansas ranks second, with 6.34 billion pounds of meat produced in 2000.

Mr. Chairman, these numbers are more than simple statistics, these figures represent jobs that are the linchpin of many of our western Kansas communities.

Therefore, it is necessary to protect the integrity of the entire beef industry. Any legislation that potentially pits one part of the livestock industry against the other, does little to address the many problems and challenges facing that industry and only creates one more. Mr. Chairman, times are especially tough at the moment. A continued and advancing drought, shortages of hay and adequate grazing land, foreign trade restrictions against U.S. beef and poultry, depressed market prices are all issues facing producers on a day-to-day basis.

Despite these formidable challenges, producers have entered into alliances and marketing agreements that allow them to gain additional dollars for the livestock they produce.

Several of these alliances already exist, or are being formed, in Kansas. And, I have been told that no fewer than 80 are in some stage of development throughout the United States.

One of the most successful of these alliances has been U.S. Premium Beef.

This producer owned cooperative has become one of the most successful producer initiated businesses I have ever seen.

Last year 13,300 cattle were marketed through USPB each week.

In fiscal year 2001, USPB cattle earned an average of \$18.95 per head in premiums over the case market. The top 25 percent earned a \$46 per head average over the cash market, the top 50 percent \$35 per head, and the top 75 percent \$27 per head more than selling on the cash market.

Mr. Chairman, during consideration of the packer-ownership amendment to the Farm Bill, U.S. Premium Beef informed me that despite the best intentions of the authors of that amendment, including an attempt to exempt such alliances from the effects of the amendment, USPB would have been put out of business.

USPB is a group of progressive and innovative producers that has found a way to

compete against the larger packers on their own dime. When they raise serious concerns about the unintended consequences of legislation, I tend to listen and have concerns of my own.

For some time, I have heard the concerns from both sides of the packer-ownership issue. I understand their concerns. Mr. Chairman, I have a good many questions regarding this important issue and now look forward to hearing the testimony and responses of the witnesses. Thank you.

**STATEMENT OF THE HONORABLE SENATOR TIM JOHNSON**

**SENATE AGRICULTURE, NUTRITION, AND FORESTRY COMMITTEE**

**HEARING ON MEATPACKER OWNERSHIP OF LIVESTOCK AND USDA  
ENFORCEMENT OF THE PACKERS AND STOCKYARDS ACT OF 1921**

**JULY 16, 2002**

Mr. Chairman, thank you for conducting today's hearing on my legislation to ban packer ownership of livestock. Last year, Chairman Harkin and Senators Thomas, Grassley and I offered an amendment to the farm bill to ban the ownership of livestock by meatpackers for more than 14 days prior to slaughter. Called the "Johnson amendment," this provision was nearly identical to S. 142, bipartisan legislation I introduced in 2001 to ban packer livestock ownership.

As a result of this major livestock-market reform and the inclusion of mandatory country-of-origin meat labeling, the Senate farm bill was the most important piece of legislation for America's livestock producers and ranchers in 80 years, since the adoption of the Packers and Stockyards Act of 1921.

Objective of "Johnson Amendment" to Ban Packer Ownership

The objective of the Johnson amendment is to increase competitive bidding, choice, market access, and bargaining power to farmers and ranchers in livestock markets. I believe America's free enterprise system only works if we have more competition, not less.

My bill strengthens Section 202 of the Packers and Stockyards Act of 1921--an 80 year old law--by prohibiting meatpackers from owning, feeding, or controlling livestock for more than 14 days prior to slaughter. Currently, packers are already prohibited from owning sale barns and auction markets.

It also exempts from the ownership ban producer-owned cooperatives engaged in slaughter and meatpacking, in addition to packing plants owned by producers who slaughter less than 2% of the national annual slaughter of beef cattle (724,000 head), hogs (1,900,000 head), or sheep (69,200). Therefore, many of the innovative, start-up projects operating and being formed to give producers greater bargaining power in the market will not be affected by the Johnson amendment.

A ban on packer ownership of livestock will not drive packers out of business, because most of their earnings are generated from branded products and companies marketing directly to consumers. However, packer ownership of livestock could drive independent producers out of business because under current market conditions producers are at the mercy of these large corporations.

Strong Support for Packer Ownership Legislation

As you know, the majority of farm, ranch, and livestock organizations in the U.S. have called upon Congress to enact my legislation prohibiting large meatpackers from owning livestock prior to slaughter. The Organization for Competitive Markets, the American Farm Bureau Federation, the National Farmers Union, RCALF-USA, the Center for Rural Affairs, and every single farm organization in South Dakota supports legislation to ban packer ownership of livestock.

Furthermore, 221 farm and rural organizations wrote the farm bill conference committee members in support of the packer ban we added to the Senate farm bill. Finally, over 120 cattle feeders from Texas, Nebraska, Colorado, Kansas, New Mexico, and Oklahoma wrote the farm bill conference seeking market fairness with a ban of packer ownership of livestock.

These farm groups know that horizontal and vertical integration of major meatpacking firms has tipped the balance of market power in favor of these packers at the expense of family-sized livestock producers.

Packer Ownership Legislative History

Thanks to your courage and leadership as Chairman of the Agriculture Committee, we were able to pass my bipartisan legislation calling for a packer ownership ban twice during consideration of the farm bill in the Senate. Unfortunately, this provision was killed by House conferees while the farm bill was pending in conference committee earlier this year.

Our packer ownership amendment was first added to the Senate farm bill on a 51-46 vote last December. However, the final farm bill was not adopted until this year. In the interim, major meatpackers lobbied hard against the Johnson amendment. Unfortunately, one of these powerful packing firms even resorted to placing an ad in several South Dakota newspapers threatening to close down the John Morrell pork plant and eliminate thousands of jobs in Sioux Falls, South Dakota unless I caved-in withdrew the amendment.

During this time, I was disappointed that some organizations and Members of Congress were fooled by these influential packers who made unsubstantiated claims that our amendment didn't clarify whether forward contracts could be used as a marketing tool by producers and packers. Packers mistakenly referred to the inclusion of the word "control" in the Johnson amendment as prohibiting forward contracts.

Forward Contracts and the word "Control"

Forward contracts have never been prohibited by my legislation. In fact, over 3 years ago former Senator Bob Kerrey of Nebraska and I first introduced legislation to ban packer ownership of livestock. Not once in those 3 years had anyone ever questioned whether our legislation allowed forward contracts. However, when the packers needed to rationalize their opposition, they twisted the truth and claimed that our legislation would prohibit all forward contracting. As a result of these scare tactics, an effort was made to dilute the Johnson amendment into a study of packer ownership.

The intent of the word “control” needs to be considered in the context of livestock ownership. In other words, control means substantial operational control of livestock production, rather than the mere contract right to receive future delivery of livestock produced by a farmer, rancher or feedlot operator. “Control” according to legal dictionaries means to direct, manage or supervise. In the case of the Johnson amendment, the direction, management and supervision is directed towards the production of livestock or the operations producing livestock, not the simple right to receive delivery of livestock raised by someone else.

There are two reasons that forward contracts and marketing agreements are not within the definition of control, therefore, forward contracts are not prohibited under my bill.

First, these contracts do not allow a packer to exercise any control over livestock production operation. Rather, the contracts merely provide the packer with the right to receive delivery of livestock in the future and most include a certain amount of quality specifications. There is no management, direction or supervision over the farm operation in these contracts. The farmer or rancher makes the decision to commit the delivery of livestock to a packer through the contract without ceding operational control. In fact, the farmer or rancher still could make a management decision to deliver the livestock to another packer other than the one covered in the contract, albeit subject to damages for breach of contract. Even where such contracts include detailed quality specifications, control of the operation remains with the farmer. The quality specifications simply relate to the amount of premiums or discounts in the final payment by the packer for the livestock delivered under the contract.

Second, several states already prohibit packer or corporate ownership of livestock, such as Iowa, Minnesota, and Nebraska. The Iowa law, for example, prevents packers from owning, operating or controlling a livestock feeding operation in that state. But packers and producers may still enter into forward contracts or marketing agreements without violating that law because operational control, in the context of ownership, is the issue. The term control is intended to be similarly interpreted and applied in the Johnson amendment.

Nevertheless, the packers successfully confused the debate about the word “control,” forward contracts, and the Johnson amendment. Therefore, I worked with Chairman Harkin and Senator Grassley to offer language in February to clarify, without question, that forward contracts were permitted under our amendment. On a vote of 53-46, our packer ownership ban remained in the Senate Farm bill.

#### Compromises Offered in Farm Bill Conference Committee, Rejected by House

During the farm bill conference committee, Chairman Harkin and I developed a number of compromise alternatives to the packer ban for the House to consider. We recognized that many members of the House Agriculture Committee were reluctant to support our amendment. Furthermore, we acknowledged that no one in the House offered any packer ban provisions resembling the Johnson amendment, and the House bill didn't prohibit packer ownership of

livestock.

First, we offered for discussion a proposal allowing packers up to four years to divest of their packer owned livestock (rather than 18 months). This offer was rejected by House farm bill conferees. Second, we discussed a creative approach to require packers to procure up to 25 percent of their daily slaughter needs from the cash market. This was Chairman Harkin's idea, and something being floated now by Senator Grassley. When we asked the House if they would consider this approach, they flatly rejected it. Finally, we even suggested "grandfathering" existing packer ownership levels, and making our legislation prospective rather than retroactive. Like a broken record, the House negotiators rejected even this compromise. Despite these and other options we proposed as compromises, House members of the farm bill conference committee completely eliminated our packer ban provision from the final bill, due to the heavy pressure from the packers and other powerful special interests who opposed the packer ban. After the Johnson amendment was defeated in conference, I wrote Chairman Harkin a letter on May 2nd seeking today's hearing. Your response was quick and I wish to commend you for this hearing.

As Concentration Intensifies, Competition Fades, and Producers Suffer

I encourage the committee to listen intently to Mr. Herman Schumacher of Herried, South Dakota, who is representing RCALF-USA at today's hearing. As Herman's testimony indicates, there are two livestock production models in the U.S. One of these models lacks competition, and it's probably impossible to restore free-enterprise for those participating in that production model. The other functions in a competitive manner on occasion, but is in jeopardy of becoming anti-competitive, unless market-oriented reforms can be made to restore meaningful competition and price discovery.

The poultry industry embodies the anti-competitive production model. Around 50 firms control every aspect of poultry production, from the growing of the live birds to slaughter. There are no farmers raising their own live birds on their own farms because these 50 firms dictate production, price, and many retail decisions throughout the entire poultry chain. As a result, there is no market transparency, price discovery, or competition.

The cattle industry represents the second production model. Approximately 1 million ranchers (19,000 which operate in South Dakota) raise cattle which are marketed to thousands of feeders before being sold to packers as slaughter-ready animals. When this model functions properly, consumer driven signals help determine prices for cattle and beef products, as well as the quality of beef. Nevertheless, when packer concentration results in these firms owning their own supply needs, the cattle market becomes volatile, manipulated, and anti-competitive.

The fate of independent producers in the pork industry is also hanging in the balance today. While it once resembled the cattle production model, it's becoming increasingly concentrated and integrated like the poultry production model. Simply put, the pork and cattle industries are in jeopardy of evaporating into the poultry model.

If meaningful competition is not restored to cattle and hog markets, livestock producers in the U.S. will become low-wage employees on their own land, working for the packing firm, bearing all of the economic risk, but none of the potential gain.

According to the United States Department of Agriculture (USDA), packer concentration has increased 45 percent in the last 20 years. During this time, the food, retailing, and packing industries have amassed profits--triple the rate of general food inflation. In fact, Cargill increased profits by 67 percent last year. Smithfield Foods, the largest pork producer and processor in the world, increased profits by 28 percent. After Tyson bought-out IBP, its profits tripled.

I believe the forces of meatpacker concentration and market collusion are factors in the depressed prices producers are receiving for their cattle, sheep, and hogs. Ranchers have fewer choices than ever as to where to sell their livestock. This lack of choice has now become a lack of market access, our producers have trouble even persuading meatpackers to buy their livestock. If this power is left unchecked, it will reduce choices for producers and consumers and further eliminate competition from markets.

#### Economic Signals Warrant Need for Packer Ban, Supply/Demand not Working in Market

The national food industry, comprised of packers and retailers aligned in order to leverage market power, continues to grow economically while independent livestock producers receive a smaller share of the consumer food dollar.

According to the United States Department of Agriculture (USDA), U.S. beef production reached an all-time high in 2000. During the spring of 2000, Choice retail beef prices were over \$3.07 per pound (retail share), boxed beef prices were \$1.20 per pound (packer share) and fed cattle prices were \$.72 per pound (producer share). In 2002, beef production is virtually the same as two years ago, yet, this spring, Choice retail beef prices increased to \$3.30 per pound, boxed beef prices remained around \$1.20 per pound, and fed cattle prices dropped to around \$.60 per pound. Sectors of the beef industry are making a profit, but it's not the South Dakota cattle rancher.

As a result, we have a meat-food industry which is doing well at the expense of our farmers and ranchers. It's evident that supply and demand signals are not in control of livestock markets, other forces are at play. Livestock markets are dysfunctional due to lack of competition and unfair trade practices. We need to strengthen the law, restore competition, and protect free enterprise, before farmers and ranchers become low-wage employees on their own land.

Consider the state of the U.S. cattle and beef market. Retail beef prices are at all-time highs, so retailers are making money. Demand for beef remains very strong, meaning consumers want to eat beef. The U.S. cattle herd size has fallen to its lowest level in 40 years, and supply and demand economics suggest this is good news for cattle prices. However, live cattle prices are abnormally low, with cattle producers losing as much as \$250 per head for cattle from just one

year ago.

Economic and legal experts, who are independent and have not received any financial support from the major meatpacking firms, have conducted a thorough analysis that supports my packer ban legislation and clarifies the debate about this issue.

This team of four experts in agricultural economics and law (John Connor of Purdue, Peter Carstenson of the Wisconsin School of Law, Roger McEowen of Kansas State, and Neil Harl of Iowa State) co-authored a report earlier this year indicating that the Senate packer ownership amendment to the farm bill addressed real problems in the competitive environment of the livestock industry, and that the claimed harm arising from the amendment was misleading at best.

Their report indicated that as the farm-to-wholesale price spread for beef has increased from the 1993-2001 time period, packer profits have increased, and competition, access, and bargaining power for independent producers has been choked-off.

Moreover, the report indicates that hog and cattle markets have 3 buyers at best, and one at worst, in any given geographic area. If a packing plant shuts down or a packer pulls out of the market for other reasons, prices suffer.

In 2001, 83 percent of hogs were committed to packers due to ownership or contract arrangements. This scenario leaves only 17 percent of the hogs in the cash market. The beef industry is also trending towards thinner open market volume. A report released by USDA's Grain Inspection, Packers and Stockyards Administration (GIPSA) in January revealed that 32.3 percent of the annual cattle slaughter was committed to packers through ownership or contract arrangements. Twenty-five percent of that captive supply number (8% of annual slaughter) was packer owned. Without a ban of packer ownership, these percentages will simply increase, while competition will disappear.

Importantly, the report notes that ownership of livestock by packers guarantees them enough supply that the packers can strategically move in-and-out of markets to affect price trends.

#### Current Laws and USDA Enforcement Inadequate to Restore Market Competition

USDA has failed to hire attorneys to lead investigations on competition cases despite the fact that Congress appropriated increased money for this purpose. And despite the fact that USDA has believed certain packer practices to be illegal, their litigators have not won a major competition case for two decades. This means current competition law is antiquated and insufficient to deal with modern-day market problems.

Even after seeking public comment on a rule dealing with packer ownership and captive supplies, USDA has been unwilling to take any administrative actions to restore producer confidence and improve competitive conditions in livestock markets. A case in point; a packer ownership-captive supply petition for rulemaking published in the Federal Register for comment in January

of 1997, hearings were held four years later on Sept 21, 2001, and USDA has done nothing since.

USDA has done a lot of studies in the past. They have found a strong correlation between increased captive supplies and price. But, they have not made a conclusion. This is a gray area where policy and Congress must step in.

If we are to restore meaningful competition for ranchers and independent livestock producers, I believe it's essential that my legislation to ban packer ownership of livestock become law.

Close

On July 3rd, Senator Daschle and I met with more than 700 farmers and ranchers in three South Dakota communities to discuss the drought and inequities in livestock markets. I asked court reporters to transcribe the discussion at our meetings, and I would like to submit that testimony for the record today.

It was revealed to us on July 3rd that some ranchers in South Dakota have had complete dispersions of their cattle herds--others are losing up to \$250 per head because they're being forced to sell cattle due to short supplies of quality feed, hay, and water. One rancher experienced a \$100,000 loss from a year ago for selling his calves prematurely. No individual or business could survive under these unfair circumstances.

A ban on packer ownership could restore competition, access, and bargaining power to markets.

This issue goes to the very heart of what agriculture will look like in the future. Will it be controlled by a handful of powerful firms, where farmers and ranchers are low-wage employees bearing all of the risk but none of the gain in the market?

Or, will it be a future with a strong patchwork of independent family farmers and ranchers contributing to rural communities that are diverse and economically strong?

I suggest Congress and USDA take the following two actions to forestall the trend of major meatpackers taking over the production of livestock in the U.S:

1. Pass my legislation to ban packer ownership of livestock, this time we need to move this legislation through the House of Representatives as well.
2. Hold a joint hearing of the Senate Judiciary and Agriculture Committees to further examine the roles that the Departments of Justice and Agriculture can play in preventing meatpacker mergers that lead to anti-competitive behavior.

Thank you Mr. Chairman for your leadership and for holding this hearing.

**Opening Statement - Senator Blanche L. Lincoln  
Hearing on Packers & Stockyards Issues  
July 16, 2002**

- Thank you, Mr. Chairman.
- And thank you to our witnesses for being here this morning, particularly our distinguished colleague, Senator Johnson.
- We are continuing a discussion we began in earnest, last fall during creation of the new Farm Bill.
- A proposed ban on packer ownership of livestock was only one of several issues that held this Committee's attention last fall as we debated, generally, the need for a Competition Title, as well as other agribusiness concentration issues.
- As most people here know, I have been skeptical of any plans to limit the ways agribusinessmen and women, whether farmers or processors, can structure or operate their businesses.
- The agriculture markets are tough out there, and they're not getting any easier.
- We understand this point well in Arkansas.
- This is why I've tried to support legislation that would

preserve for farmers and ranchers as much marketing and planning flexibility as possible.

- It's also why I opposed the proposed ban on packer ownership last fall during the Farm Bill debate.
- As we see agriculture markets adjust to greater global trade, and as we watch our farmers and ranchers adjust to the changes this increased brings, I urge my colleagues to observe caution as we debate any legislation that would effectively restrict marketing and business planning flexibility.
- With these thoughts, I thank the Chairman and our witnesses, and I look forward to their testimony.

Testimony of Bill Hawks  
Under Secretary for Marketing and Regulatory Programs  
U.S. Department of Agriculture  
before the  
United States Senate  
Committee on Agriculture, Nutrition, and Forestry  
July 16, 2002

Mr. Chairman, good morning and thank you for the opportunity to appear before this Committee to discuss the proposed ban on packer ownership and USDA enforcement of the Packers and Stockyards Act.

I am Bill Hawks, Under Secretary for Marketing and Regulatory Programs. With me is Donna Reifschneider, Administrator of the Grain Inspection, Packers and Stockyards Administration (GIPSA).

As you know, GIPSA is divided into two parts: the Federal Grain Inspection Service and the Packers and Stockyards Programs. The Federal Grain Inspection Service establishes Federal grain standards and oversees the official inspection of U.S. grain. Packers and Stockyards Programs administers the Packers and Stockyards Act of 1921 (the P&S Act), which prohibits unfair, deceptive, and fraudulent practices by market agencies, dealers, stockyards, packers, swine production contractors, and live poultry dealers in the livestock, poultry, and meatpacking industries.

GIPSA has an important role in protecting the interests of producers by helping assure integrity in the Federal grain inspection system and the markets for livestock, meat and poultry, and I am committed to ensuring that livestock and poultry producers are paid promptly and that livestock marketing firms, meatpackers, poultry integrators, and meat distributors face appropriate consequences if they engage in anticompetitive and unfair market behavior.

Packers and Stockyards Programs (P&SP) monitors the livestock, meatpacking, and poultry industries, estimated by the Department of Commerce to have had an annual wholesale value of \$125 billion in FY 2001. At the close of 2001, there were 1,525 stockyards, 6,241 market agencies and dealers, and 2,050 packer buyers that were subject to the P&S Act and registered with P&SP. An estimated 6,000 slaughtering and processing packers are subject to the P&S Act. This included 249 slaughtering packers in FY 2001, each of whom purchased over \$500,000 of livestock in 1999 and were required to be bonded and file reports with GIPSA. In addition, 205 poultry firms and a significant number of meat distributors, brokers, and dealers are subject to the P&S Act. To monitor these industries, P&SP has an annual budget of less than \$18 million and less than 200 employees. Despite the small size of P&SP, P&SP's work in the regulated industries resulted in the recovery or return of about \$20 million to producers or the regulated industries. The men and women who comprise P&SP are as committed as I am to enforcing the P&S Act, and are up to meeting the challenges of the rapidly changing livestock, meatpacking and poultry industries.

Last fiscal year alone, P&SP conducted 1,619 investigations in our three areas of regulatory responsibility: financial, trade practice, and competition. About 400 of these investigations resulted from complaints filed with P&SP, and the remaining investigations were initiated by P&SP as a result of monitoring industry behavior, following up on problem areas, responding to questionable items on reports to P&SP, and other activities revealing information about the industry. If you look at each of these areas, you will see that we are indeed enforcing the Packers and Stockyards Act.

In the area of financial protection, P&SP conducted 715 investigations in FY 2001 to investigate complaints and monitor the financial integrity of the livestock, poultry, and meatpacking industries. These investigations included alleged failure to pay for livestock or poultry; failure to pay when due for livestock or poultry; operating while insolvent; failure of market agencies to properly maintain custodial accounts; and enforcement of the packer trust provisions of the P&S Act.

We also provide financial protection in ways that are not measurable. For example, when Farmland Industries declared bankruptcy on a Friday, we made arrangements to have rapid response teams on site at every Farmland plant on the following Monday to conduct prompt payment investigations to ensure that producers were receiving payment and to ensure that Farmland had sufficient trust assets in the event of a complete financial failure. By doing this, we helped maintain stability throughout the hog market. Any time there is a financial failure by a packer or live poultry dealer, P&SP sends out rapid response teams to conduct a trust analysis so that trust assets can be distributed as quickly as possible. Although we do not have statutory authority to make the ultimate decision as to whether or not the claims are valid, we believe we have contributed to a more expeditious payout of trust assets.

In the area of trade practice, P&SP helps assure, among other things, that firms: Adhere to the terms of poultry production contracts, buy and sell on the basis of accurate weights, not misrepresent weights, animal or carcass quality or prices, have sufficient bonds to cover purchases of livestock and poultry, and not discriminate against or give undue preferences to certain sellers or buyers. P&SP also regulates Internet firms that serve as market agents in buying and selling livestock.

I would like to share with you some examples of investigations in the competition area that are currently underway. While I cannot go into much detail because these are ongoing investigations, it will give you an idea of the steps we are taking to enforce the P&S Act in the area of competition. An investigation in the poultry industry will examine whether there is a disparity between the way integrators treat growers who are geographically isolated and do not have a choice of integrators and those who have several integrators to choose from for contracting and if so, if there is a violation of the P&S Act. During the process of that investigation, we are going to look into poultry integrators' use of mandatory arbitration clauses. We are investigating how hog packers are using meat prices to price hogs. Following the event of September 11, there was a sharp decline in prices in the livestock market. We conducted an investigation to determine if packers were taking advantage of the situation in violation of the P&S Act. We have determined that they were not and that the price declines were due to other

factors. We conducted that investigation in conjunction with the Commodity Futures Trading Commission (CFTC). With the CFTC, we also investigated whether rumors about an outbreak of foot and mouth disease in Kansas may have been used to manipulate market prices. Again, we determined that there was no evidence of violation of the P&S Act.

We have taken dramatic steps to improve our ability to handle competition cases. We have carefully considered all of the counsel that we have received from both the Office of the Inspector General within USDA and the General Accounting Office's recommendations that were made in its 2000 report to Congress on steps that USDA could take to improve GIPSA's ability to investigate anticompetitive activities.

In 1998, GIPSA completely restructured P&SP and consolidated more than 11 field offices into 3 regional offices with each one having primary responsibility for certain species—Atlanta for poultry, Des Moines for swine, and Denver for cattle and sheep. In addition, some 35 resident agents provide service in States that no longer have a regional office. Headquarters and regional offices were reorganized along functional lines, with separate units for trade practices, financial protection and competitiveness investigations. The restructuring was completed in 1999. Since then, P&SP has been working to recruit and train new economists and legal specialists, develop new operating procedures, and develop working relationships among the new offices and with the Office of the General Counsel. P&SP now has about 30 economists and seven legal specialists.

P&SP is now very different from the agency that existed in 1990. We have shifted the focus of our employees' skill sets and are moving beyond our traditional investigatory skills relating to failure to pay and unfair or deceptive practices, to undertake more complex investigations of possible apportionment of territory, manipulation or control of prices, and other behavior made unlawful by Section 202 of the P&S Act. These complex investigations require novel economic theories, econometric analyses and other sophisticated technical skills. Now in addition to auditors and marketing specialists, we have a contingent of economists having Master's and Ph.D. degrees. We have licensed attorneys who serve as legal specialists. We have one regulatory analyst and we are hiring more. We have increased the grade levels of all of our senior positions for economists, legal specialists, auditors, and marketing specialists so we can hire and retain more qualified employees.

We are working more closely with the Office of the General Counsel. We are developing work plans for every competition investigation and some other complex investigations. We have revised our employee manual and we continue to revise it on a daily basis as we develop and refine our policies. These are all changes that are not going to be readily apparent to the industry but that will make a significant difference in our efficiency and effectiveness.

We have undergone a dramatic internal shift in how we look at the industry, how we deal with the industry and how we present ourselves to the industry. We have identified concerns about industry practices in our annual assessment of the cattle and hog industries. This is an annual report that we provide to Congress and that we distribute when we go out to speak with groups and with individual firms. We are trying to make the industry much more aware of the requirements of the P&S Act. We are inviting industry participants to let us know what their

issues are and to give us information about their new programs or practices before implementing them. This level of open communication with the regulated industry is a new step for us and it has been met with a great appreciation by the industry.

While we have been repositioning P&SP to more effectively enforce the P&S Act, the P&S Act itself has not undergone any significant review in many years. Some intended beneficiaries of the P&S Act (including some feeders, producers, and ranchers) express their belief that consolidation and new marketing methods violate the P&S Act.

Despite our increased efforts to enforce the competition provisions of the Act more effectively, many believe that P&SP is not enforcing the Act because we have not taken any action against packers for consolidating or procuring livestock through the use of captive supply arrangements. However, the P&S Act does not prohibit consolidation or the use of captive supplies. Consequently, unless packers consolidate or use captive supplies in a manner prohibited by the Act (e.g., to apportion territory or manipulate or control prices), neither consolidation nor the use of captive supplies is unlawful.

Earlier this year, we published our Report on the Issue of Captive Supplies in the Cattle Industry. As you know, we reported several significant findings. First, despite its common usage throughout the livestock and meatpacking industries, there is no common definition of the term "captive supply." In general, we define captive supply as livestock that are owned or committed to a packer more than 14 days prior to slaughter. In follow-up discussions with six of the top beef packers, P&SP officials confirmed that packers have no common definition of "packer ownership." P&SP defines "packer ownership" as livestock in which a packer has any ownership interest.

Second, in 1999, the top four beef packers met 8 percent of their procurement needs through cattle that they had any ownership interest in; 24 percent of their procurement needs were met through other captive supply arrangements. We have recently completed a review of top four beef packers 2000 procurement data. Our preliminary analysis indicates that the top 4 firms met 9 percent of their procurement needs through packer owned cattle and 29 percent through other captive supply arrangements.

In addition to the findings of our Captive Supply Study, a significant number of economic studies have been conducted on the short-term effects of captive supplies of cattle on spot market prices. While these studies have shown a correlation between the levels of captive supply and lower spot market prices, they have not shown that captive supplies cause lower prices or that there would be any violation of the P&S Act from captive supply use. In the hog industry, there has been some research on the extent and reasons why parties enter into captive supply arrangements, but there is little research on the effects of packer feeding and forward sales of hogs or other types of livestock. Unfortunately, studies have not fully examined such critical issues as the incentives for entering into captive supply arrangements and the long-run effects of captive supplies on prices, efficiencies and other economic and market factors.

Packer ownership, like all forms of captive supply, has broad ramifications for the livestock and meatpacking industries. We know that a wide range of alternative marketing arrangements is

emerging, and that the arrangements are being adopted because the participants believe they are beneficial. Other industries also are adopting similar marketing arrangements. Any actions that would limit participants' ability to enter into alternative arrangements could have profound implications, including possible unanticipated consequences, for market participants and consumers, and for the ability of the livestock industries to compete for consumer spending in the United States and export markets. It is difficult to make important public policy decisions about these arrangements in the absence of sound analyses of their use and implications.

Given the lack of information about why packers enter into packer feeding arrangements, why producers and others enter into other captive supply arrangements, and the implications of these arrangements for the livestock industry and downstream markets for meat, we are considering a comprehensive study on Livestock and Meat Marketing. We are in the process of developing plans for a study would provide Congress with information that would assist Congress, in a deliberative manner, determine whether the P&S Act should be amended to ban certain marketing practices. The study would need to be accepted as valid by the regulated industries and the market participants who benefit from the Act's protections. We would be committed to conducting the study in a timely manner without rushing to conclusions, but we would be committed to reaching conclusions.

It may be time for a review of the P&S Act to determine the best way for it remain vital in the 21<sup>st</sup> century. P&SP is planning this comprehensive review and has started to reach out to various industry groups to incorporate them into this process. When the review is complete, it will provide relevant information for public policy formulation.

In conclusion, I want to iterate that we are committed to ensuring that producers are paid promptly and that firms subject to P&S Act jurisdiction do not violate the Act without facing appropriate consequences. We are taking steps to achieve this goal and look forward to working with the Congress to address these issues. I will be happy to respond to your questions.

WRITTEN TESTIMONY OF  
THE ORGANIZATION FOR COMPETITIVE MARKETS  
presented to the  
UNITED STATES SENATE  
COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY

July 16, 2002

**Hearing on Proposed Ban on Packer Ownership of Livestock and  
USDA's Enforcement of the Packers & Stockyards Act**

Thank you Chairman Harkin and members of the Senate Committee on Agriculture, Nutrition and Forestry for allowing me to speak here today. My name is Michael Stumo and I am general counsel for the Organization for Competitive Markets. OCM is a multidisciplinary nonprofit organization that focus exclusively on antitrust and competition problems and solutions in agriculture. Our members consist of farmers, ranchers, academics, policy makers and agricultural businessmen.

The U.S. food industry grosses approximately \$900 billion in annual sales. It is the biggest industry in the country and in the world. That money is distributed through the agricultural market infrastructure. Our family farms and ranches, as well as our rural communities, were built on that money. A perfectly competitive market would distribute that money properly. A noncompetitive market does not allow that money to flow to rural communities. Rather, dominant firms utilize their position to obstruct that monetary flow and enrich themselves far beyond the level that could otherwise be achieved without near-monopoly power. The result is an increasing rate of farm failure, increased consumer food prices, and harm to the public interest.

**I. The Nature of Agricultural Markets and the Need for Market Facilitating Rules**

The role of government in the marketplace is to create and maintain the infrastructure for the most people and companies to engage in commerce. The analogies are the internet and the U.S. interstate highway system. The internet is not commerce or communication. Rather, it is an infrastructure that facilitates cheap and effective commerce and communication. It is not proprietary. It is accessible by most everyone, and it is very easy to access.

Similarly, the U.S. interstate highway system is not commerce. It facilitates commerce. Everyone can use it. There are many on ramps and off ramps. General Electric uses the system and so does my mother. The government maintains it and applies a set of equitable rules to the infrastructure. The payback has been incredible.

It may be efficient for four companies to acquire exclusive use of 50% of the internet or 90% interstate highway system. But it is efficient only for the companies' profitability. It is not beneficial for the country because it denies the benefits of commerce and communication to the displaced users.

The livestock marketplace must be similarly open, accessible and fair to benefit the broadest number of people. We must have rules that maintain access by all through many on-ramps and off-ramps. We must maintain inexpensive use by all under equitable terms. If a company feels it would be more efficient to exclude others from the system, that desire must be recognized as in conflict with the public welfare. We must maintain the ability for the broadest participation in commerce possible for widespread rural economic health.

Federal policy applied to the stock markets has promoted fairness, access, transparency and competition in the stock markets. The result is that 80 million people own stock, a far larger percentage of the population than of any other country, and those people can make trades easily and cheaply. Federal policy applied to the livestock markets has promoted unfairness, market closure, secrecy, and monopolistic practices.

We need to rethink the emphasis on efficiency in macro-market policy. "Efficiency" is relevant to a firm producing more for less money, but it is far less relevant to proper market operation. Stated another way, if efficiency gains occur, a competitive market will distribute those efficiency gains to society. In a non-competitive market, the efficiency gains are not distributed.

The analysis relating to market facilitation and efficiency should be as follows: First, the focus should be on creating a market system that is fair, accessible, transparent and competitive. The internal logic here is separate from efficiency. Second, if efficiency is raised as a negative factor, the following four questions must be asked before balancing the efficiency argument with the anticipated market facilitation effects: (1) Are the claimed efficiency gains/harm real? (2) Are the efficiency gains directly related to the market practice at issue? (3) Is there no other way to achieve the claimed efficiency gains? (4) Are the efficiency gains likely to be passed on to consumers or farmers, or is market power likely to obstruct passing the gains on to others. If the efficiency gains are real, related to the practice at issue, achievable in no other way, and likely to be passed on to consumers/producers, then we can quantify what efficiency gains are relevant and weigh them against the positive effect of the market facilitating rules contemplated.

#### **A. Captive Supplies: The Problems**

Captive supplies of livestock are all livestock committed to packers through packer ownership and contracts more than seven days prior to slaughter.<sup>1</sup> The fundamental market problems of captive supplies are threefold: (1) market closure; (2) market unfairness; and (3) enabling packers to "game the system" just as Enron and Dynegy gamed the energy trading system.

##### **1. Market closure**

Captive supplies have progressed to the point where hog farmers cannot get bids or access to markets, even in states with large packing capacity, such as Iowa, Nebraska and Minnesota.

<sup>1</sup> The industry, specifically most cattlemen's associations that have addressed the issue, uses the seven day rule. However, USDA-GIPSA uses a 14 day prior-to-slaughter rule. See, USDA GIPSA publication, "Captive Supply of Cattle and GIPSA's Reporting of Captive Supply," released January 18, 2002 (on the web at [www.usda.gov/gipsa/pubs/captive\\_supply/captive.htm](http://www.usda.gov/gipsa/pubs/captive_supply/captive.htm)).

Pork packers own 20 percent to 25 percent of the hogs they slaughter. That is 77,000 packer owned hogs per day at 22%. That is over 20 million hogs per year that displace family farm produced hogs. This, at its core, dampens or excludes widespread rural commerce. If we like a diverse and decentralized production system, we are not promoting it.

But what of the remaining "open market" participants? We know that about 16% of each day's slaughter is claimed to be open market, using USDA daily market news reports.<sup>2</sup> No one disagrees that farmers have difficulty accessing the market. But what is not widely known is that most farmers who seek bids on their hogs no longer get bids, even in Iowa which has more pork slaughter capacity than any other state. Rather, they get "slots" or "shackle space" at some time in the next seven to fourteen days. The packer tells the farmer what the price is after the hogs are delivered. That price is reported to USDA Market News Service. No bids. No competition. That is our dysfunctional open market price discovery system. We are losing much decentralized economic activity in the form of broad family farm market participation.

## 2. Market unfairness

To the extent participation is allowed in the markets, participants are treated unequally. Large corporate producers receive preferential contracts. For example, the large feedyards owned by Sparks, called Cattle Co., appear to have contracts with packers which allow significant price advantages over other producers of cattle. It is undisputed that producers are treated disparately with regard to contract offerings, bids, and access. But it is disputed whether these practices are legitimate. If we apply basic and successful market principals to our evaluation of these activities, the answer is clear that disparate treatment is contrary to proper market operation and contrary to the public interest.

If a small farmer produces high quality hogs, he/she should get access to prices and shackle space according to quality, not quantity. If a large farmer produces high quality hogs, the same result. Size is not relevant to hog quality. Further, the transaction costs arising from purchasing from many producers, rather than a few large producers, is so small as to be insignificant. The primary goal should be fairness and access to facilitate widespread and decentralized rural commerce.

A properly functioning free market provides uniform rules for all participants on price, premiums, discounts and access. The stock market does so. Warren Buffet gets no better terms than Michael Stumo when buying stock at a particular time – even if he buys 500,000 shares of GE when I buy 50 shares. Buffet may analyze information and have better strategies to time his purchases and sales, but we have equal market access at the same price on any given time and date of trading. The same should be true in the livestock markets.

The Packers & Stockyards Act should be to "live-stock" what the Securities and Exchanges Acts are for "paper-stock." The law is written to enable this result, but USDA has failed. More on that later.

<sup>2</sup> This 16% contemporary figure is part of a declining trend in open market hog trading. If the current trend continues, the open market will disappear in 2004.

### 3. Manipulating or Gaming the System: The Incentive Structure

When constructing proper market rules, the proper approach is to counteract the incentives to manipulate the market or “game the system.” Looking for proof of harm after-the-fact is not beneficial and this method has failed. Further, a focus on efficiency has not proven helpful and has failed.

Enron and Dynegy “gamed the system” with regard to California energy markets. They used strategies such as Death Star, Fat Boy and Get Shorty in creating fictional transactions, creating perceived shortages, and trading advantageously in the situation they created. They got wealthy, but Californians were thrown into crisis.

When undue importance is attached to a number, undue efforts are made to manipulate that number. On Wall Street, the *key number* is earnings. Shady accounting strategies are used to manipulate that number. Bernard Ebbers of WorldCom is the poster child for this scenario. But tremendous energy is expended by defenders to justify those strategies as legitimate. In the livestock markets, the *key number* is the open market price. Similarly, shady marketing strategies are used to manipulate that number. And tremendous energy is expended by defenders to justify those strategies as legitimate.

Captive supplies, such as contracted and packer owned livestock, are the raw material for market strategies equivalent to Death Star and Fat Boy. By strategically scheduling captive hogs to stay out of the market, drive the price down, and jump into the market to buy at low prices, packers make tremendous amounts of money. Farmers lose tremendous amounts of money. Yet valiant attempts are made to convince us that captive supplies are justifiable.

The fundamental principal here is that when the market is dominated by a few firms that are repeat players in a very thin market, the motive and opportunity to manipulate that thin market is so real as to be undeniable. Bob Peterson, former CEO of IBP, spoke to the Kansas Livestock Association in 1988. The following comes from the tape of his speech:

“Our competitors are promoting contracts and seeking more. These forward contracts coupled with packer feeding could represent a significant percentage of fed cattle at certain times of the year. **Do you think this has any impact on the price of the cash market? You bet! We believe a significant impact.** Large volume forward contracting and its inevitable connection to the futures trading pit in Chicago will foster severe price distortions in the cash market. In the event that contracting becomes the wave of the future, and frankly I doubt that sharp feeders will allow that to happen, IBP will be forced to respond to the competitive pressures of the market place.” (emphasis added)

Even Wayne Purcell of Virginia Tech, who opposed the packer ownership ban, understands the manipulative incentives in the current system.<sup>3</sup> In testimony before USDA in Denver in September, 2000, he wrote that “[w]hether buyers attempt to manipulate the cash market to which the contract price is tied is somewhat immaterial because the incentive to do so is present

<sup>3</sup> Purcell, Wayne D., *Contracts And Captive Supplies In Livestock: Why We Are Here, Implications, And Policy Issues*, Testimony at the Denver Captive Supply Forum, dated September 21, 2000.

and is undeniable.” It is this motive and opportunity, aka the “incentive structure,” that should govern legislative judgment to prevent manipulation.

Past USDA studies have shown a high correlation between increased captive supplies and lower prices. The most detailed study of this relationship was published in 1999, using subpoenaed packer information with the support of USDA. That study, in the beef industry, found that “a robust empirical relationship [between captive supplies and low prices] was found in every case.<sup>4</sup> For folks who are confused, this means that when captive supplies are dumped on the market, prices drop. The economic incentive is thus shown. More captive supplies make more money for packers.

USDA explains this away saying that this correlation does not give them causation. But economists cannot achieve “causation.” Rather, a major ADM-style price fixing case with testimony, hidden cameras, and the like is necessary to give causation to the extent needed by USDA. It is time for a legislative judgment to be made.

The USDA Let us quantify the economic incentive to game the system by using captive supplies to manipulate the price through an example. If packers can use captive supply to drive down the open market price by one dollar on a day, the procurement savings is \$910,000 each day (assuming a daily hog slaughter of 350,000 head at 260 pounds per animal). That is \$910,000 taken from farmers. On an annual basis, that is \$237 million taken from farmers and transferred to packers as compared to a competitive market result. If captive supplies drive the price down by two dollars per day, we double the farmer loss and double the packer gain.

How can a dominant packer buyer game the system? The easiest way is for a packer to schedule blocks of captive supply livestock for slaughter over a period of time, pull out of the market during that time and watch the open market price fall. Then the packer can jump into the open market to buy cheaply. That cheap open market price not only saves money on the open market hogs directly, it also cheapens the tens of thousands of hogs per day that are contracted using a formula based on the open market price. If any packer buyer does not know how to do this, it is likely that any such packer buyer has moved on in his career.

Further, a packer contracts for the best hogs and, as a result, the open market becomes residual. By “residual,” it is meant that the poorer, less desirable hogs are sold on the open market. The open market price reported by USDA Market News Service is, thus, the value of the poorest quality animals. The perverse result is that the poor quality hog price becomes the base price for the hogs procured under formula-price contracts (“formula price” contracts derive the sale price based on a formula which uses the open market price as the starting point).

Additionally, the futures market relies most heavily on the open market in determining price for the future. If the open market is broken, the damage is transferred to the futures markets. In other words, the captive supplies derivatively drive down the futures market because of futures traders’ heavy reliance on open market price data.

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<sup>4</sup> John R. Schroeter and Azzedine Azzam, *Econometric Analysis of Fed Cattle Procurement in the Texas Panhandle* 46 (November 1999).

Lastly, because producers selling in the open market have no realistic bid choices, they engage in “panic selling” rather than negotiation. Certainly it is difficult to negotiate when there is only one willing buyer in the region and that buyer does not bid but merely doles out shackles with the promise of an arbitrary “price” upon delivery. The cumulative result of panic selling is not a price arising from a competitive market. From what is that post-delivery price derived from, a market? Packer gratuity? Certainly not competitive bidding.

#### B. Captive Supplies: The Solutions

The only solution to captive supplies is structural, not a conduct remedy. By a “structural remedy,” I mean limiting or eliminating the partial vertical integration known as captive supplies. A “conduct remedy” means that we do not limit captive supplies but merely pass or enforce a law to prevent unlawful conduct that captive supplies could enable. Structural remedies are preferred because they do not require significant policing due to the fact that the ability to manipulate markets is taken away from dominant firms. Conduct remedies are not preferred because they require constant policing by regulators in a very intrusive way to be effective. Such constant policing has historically not been undertaken or effective.

##### 1. Packer Ownership Prohibition

The packer ownership prohibition is the first step in making the markets work properly and limiting the ability of packers to game the system. This legislation would take a portion of the strategic scheduling ability away from the dominant packers and make the market more responsive to true supply and demand. It would also increase access to markets by more producers.

While some studies predicted crisis from banning packer ownership, those studies can be dismissed by one simple analysis – i.e. the historical record. The studies were not based upon the historical record, but upon wildly speculative economic projections. We know that the drastic financial losses in the industry will not occur because packer ownership prohibitions have been in effect for several years in Iowa and Nebraska. The predicted losses did not occur. Those states had, and continue to have, the largest packing capacity for hogs and cattle, respectively, in the nation. Those states have as many or more producers of hogs and cattle as any state. The strength or decline in production agriculture has not been affected in a manner more drastic than other states. Yet, the percentage of family farmers producing livestock is as high or higher than other states.<sup>5</sup>

##### 2. Enzi legislation on livestock contracts

Senator Enzi has proposed a bill (S. 2021) that would require all contracts to have a fixed base price at the time of the agreement and would also require open public bidding of these contracts. This bill would transform the contract market from a secret, preferential, market harming scenario into an open market in and of itself. A contract market would still allow quality

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<sup>5</sup> See, Welch, et al., “On the effectiveness of state anti-corporate farming laws in the United States,” *Food Policy* 26 (2001) 543-548.

specifications and risk management. But it would severely limit the ability of packers to use contracted supplies to manipulate price.

Importantly, the Enzi bill has basic requirements for the contracts similar to the futures markets. There is a relatively small volume requirement, 40 head per contract for cattle and 30 head for hogs, that allow small producers to bid on contracts while large producers bid on more contracts. However, that legislation could be improved by adding a 14 day delivery window for each contract to limit strategic scheduling by the packer to affect the spot market price.

## II. The Regulatory and Enforcement Regime

The Packers & Stockyards Act (the Act) gives Secretary of Agriculture authority over the meat packing industry.<sup>6</sup> Unfortunately, past secretaries (or their designates) have stood before Congress stating that their authority is unclear or insufficient to encompass antitrust issues under the Packers & Stockyards Act. Those statements have been false. The Act provides the Secretary more authority over the packing industry than any other statute provides any other agency over any other industry. The Conference Report issued at the time of the Act stated that “Congress intends to exercise in the bill, the fullest control of the packers and stockyards which the Constitution permits.”<sup>7</sup>

The Act prohibits unfairness, deception, price manipulation, and the creation of a monopoly, among other things.<sup>8</sup> The role of the secretary is, and has been, to undertake two categories of activities: (1) propound regulations refining the definitions of the prohibitions in the Act; and (2) enforce the Act and the regulations under the Act. Past secretaries have failed to perform these obligations. The current secretary shows no inclination to alter that trend.

### A. Rulemaking

The most inexpensive way to facilitate proper market operation, to minimize industry efforts to “game the system,” and to increase fairness, access, transparency and competition is to propound regulations under the Act.

It is helpful to look to the FTC Act of 1914 as an analogy because of its similarities to the P&S Act and because of its more effective caselaw and regulatory development. The FTC Act prohibits “unfair and deceptive practices” as well as “unfair competition.” The FTC has issued regulations and guidelines defining what these terms mean in the economy. The “unfair and deceptive practices” have given rise to the FTC’s Consumer Protection Bureau while the “unfair competition” clause gave rise to the Competition Bureau. A similar dichotomy in the P&S Act in which the unfairness and deception clauses relate to “Producer Protection” while the price manipulation and monopoly creation prohibitions relate to competition or antitrust.

Unlike the FTC, the Secretary has failed to issue regulations or guidelines defining the key terms of the Act, including:

<sup>6</sup> 7 U.S.C. §§181 et seq.

<sup>7</sup> Conference Report, H.R. Rep. No. 324, 67 Cong. 1<sup>st</sup> Sess., at 3 and 5-6 (1921).

<sup>8</sup> 7 U.S.C. §192.

- a. unfair practices under 7 U.S.C. 192(a);
- b. deceptive practices under 7 U.S.C. 192(a);
- c. unjustly discriminatory practices under 7 U.S.C. 192(a);
- d. undue or unreasonable preference or advantage under 7 U.S.C. 192(b);
- e. apportionment of supply that restrains commerce or creates a monopoly under 7 U.S.C. 192(c);
- f. price manipulation, control of prices or creation of a monopoly under 7 U.S.C. 192(d);
- g. conspiracies under 7 U.S.C. 192(f) and (g); and
- h. apportionment of territory, apportionment of purchases or sales, or manipulation or control of prices under conspiracy under 7 U.S.C. 192(f).

Further, the Secretary has failed to issue regulations or guidelines for other duties under the Act, including:

- a. defining unusual or suspicious marketing activity or pricing;
- b. when and how to refer violations of the Packers & Stockyards Act to the Attorney General as set forth in 7 U.S.C. §404;

This failure to refine and define the Act through regulations is at the heart of the USDA's failure to minimize unfair and deceptive practices and maximize competition. Without internal policy guidance, the USDA is limited to an ineffective "I know it when I see it approach" which gives no direction to employees investigating market activity.

Two reasons for these failures are USDA responsiveness to industry pressure and a pre-occupation with efficiency as a primary goal. USDA fails to recognize that: (a) efficiency is irrelevant to unfair or deceptive practices; (b) efficiency is irrelevant if lack of competition fails to pass efficiency gains on to producers or consumers; and (c) efficiency is a micro-concern within a firm and increasingly conflicts with competition principals.

#### B. Enforcement

Even if rules are clear, intelligent and effective, they are without value unless enforcement is effective. Enforcement of the Act can come from three sources: (1) USDA-GIPSA in an administrative proceeding; (2) the Department of Justice in federal district court; and (3) private litigation. Public enforcement by USDA has failed. Public enforcement by the Department of Justice has not existed. Private enforcement has been hampered by the lack of an attorneys fees provision and a treble damages provision, both of which exist under the Sherman and Clayton Acts, to help farmers pursue remedies when they have been harmed.

What is the role of each means of enforcement? USDA and DOJ enforcement – in the best case scenario of political will, sufficient expertise, and sufficient funding – is limited to high profile cases that set precedent. Government enforcement cannot hope to be the primary means of stopping all unlawful practices. Rather, private litigation by farmers and ranchers who are

actually harmed is the best way to guarantee effective and widespread enforcement of the run-of-the-mill violations.

#### 1. USDA enforcement

USDA has tried to use enforcement proceedings before administrative law judges as a substitute for rulemaking. Using their I-know-it-when-I-see-it approach, and without the guidance of regulations, USDA has sued major meatpackers for preferential pricing (In re Beef Marketing Group) and unlawful market retaliation (In re Farmland National Beef Co.), for example. While those cases were mid-to-late-1990's exceptions to the historic "lack of any enforcement rule" at USDA, they failed to succeed primarily due to the lack of regulations defining unlawful practices under the Act. The administrative law judges hearing these cases had no regulations to guide their decision making and were left to ad hoc decision making. Because of those enforcement failures in the recent past, USDA is even more reluctant to litigate and has not begun to propound necessary regulations.

Even if USDA was willing to, and able to (funding and expertise-wise), increase enforcement activities, only the most significant cases would be undertaken – those with precedent setting potential. This is the history of enforcement in other antitrust contexts at DOJ and FTC. While this approach would be laudable if undertaken, there is no prospect that USDA can address all unlawful activities in the countryside.

#### 2. DOJ enforcement

There is a process by which DOJ may be called upon by the Secretary to bring an enforcement action under the Act in federal district court.<sup>9</sup> However, to OCM's knowledge, this process has never been utilized. Again, the best case scenario is that this mechanism of enforcement would be limited to precedent setting cases, rather than run-of-the-mill violations.

#### 3. Private litigation

The Act allows producers to engage in private litigation in pursuit of damages caused by packer harm.<sup>10</sup> Private litigation historically holds the most promise for comprehensive enforcement. This is because the incentive is extremely strong for those actually harmed by unlawful activities to pursue a remedy. However, the number of private cases has been very small since private suits were allowed in 1976.

The reason that farmers and ranchers have been unable to prosecute private suits is that there are no attorneys fees provisions or treble damages provisions under the Act. The Sherman and Clayton Acts have such provisions and, thus, private enforcement has complimented public enforcement. Without these provisions, the cases are too expensive to undertake due to their complex nature and the vigorous defense of packers. The solution is to amend the Act to allow farmers who win a suit to receive attorneys fees and treble damages. This is not a sop to trial attorneys, it is a provision needed for farmers to gain effective legal representation.

<sup>9</sup> See, 7 U.S.C. §224.

<sup>10</sup> See, 7 U.S.C. §209.

### C. Solutions within USDA

Rulemaking and enforcement of the Act must be given a higher priority at USDA. This high priority must be accompanied by more professionalism, focus and funding directed at competition and fairness issues. Currently, GIPSA is a small, underfunded corner of the vast USDA bureaucracy. Field investigator recommendations for enforcement activity must go through several layers of bureaucratic scrutiny before final approval – and final approval for significant action usually does not occur.

Again, an analogy to the FTC is helpful. In the late 1960's, the Federal Trade Commission was justly criticized for being ineffective and unprofessional. A Nader Report and an American Bar Association report criticized the FTC for: poor leadership, lack of direction, aimless enforcement, and squandered resources. The fundamental question was whether the agency should be abolished or reformed.<sup>11</sup> The FTC chose to implement the solutions recommended in the ABA report.

In a June 12, 2001 speech before the American Antitrust Institute, current FTC chairman Timothy J. Muris recalled those thirty-years-ago changes:

*For consumer protection, the Report prescribed vigorous law enforcement and a national role in developing consumer protection policy. More specifically, it recommended that the agency:*

- *Focus enforcement on serious consumer problems, especially fraud.*
  - *Mount a more effective campaign against deceptive advertising.*
  - *Strengthen its remedies and reduce delays.*
  - *Provide industry guidance and incentives for compliance and self-regulation.*
- *Undertake studies, issue reports, and make legislative recommendations directed at pressing consumer issues.*
- *Work with state and local consumer protection agencies.*
- *Make consumer education part of the agency's mission.*

*For competition, the Report prescribed that the Commission use its unique history and institutional advantages - those not available to the Department of Justice Antitrust Division - to advance competition policy and enforcement. More specifically, the Report recommended that the agency:*

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<sup>11</sup> See, Muris, Timothy J., "Robert Pitofsky: Public Servant and Scholar," Speech to the American Antitrust Institute, June 12, 2001. (available at [www.ftc.gov/speeches/muris/muris010612.htm](http://www.ftc.gov/speeches/muris/muris010612.htm)).

- *Use the "full panoply" of its institutional tools to make competition policy - doing research, publishing studies, bringing cases, and making use of the intersection of competition policy and consumer protection authority.*
- *Formulate national competition policy by using the administrative process to adjudicate cases.*
- *Make policy involving "unsettled" areas of the law.<sup>12</sup>*

Thus, the FTC became far more effective and respected.

GIPSA is in a similar position to the old, ineffective FTC. It currently suffers from poor leadership, lack of direction, aimless enforcement, and squandered resources. However, it can use the tools at its disposal to provide focus and effectiveness, including: rulemaking, studies, legislative recommendations and enforcement. It can take advantage of the confluence of its producer protection authority and competition authority to set national policy towards a more fair, accessible, transparent and competitive market infrastructure.

Congress can facilitate this process by creating an undersecretary level position at USDA with the following (or similar) title: Office of Special Counsel for Competition and Producer Protection. The position should be filled by an attorney experienced in such matters, appointed by the president with the advice and consent of the Senate. That office, under this scenario, would house all USDA authority and personnel relating to agricultural competition and fairness such as the Packers & Stockyards Act, the Agricultural Fair Practices Act, and the Mandatory Price Reporting Act. The office would have the authority to propound regulations, initiate enforcement proceedings, interact with the Department of Justice, conduct studies and recommend legislation.

The goal should be an FTC-style remake of USDA-GIPSA. USDA is the largest agency after the Department of Defense. It engages in a wide variety of activities other than antitrust-style enforcement. If Congress agrees with farmers and ranchers that competition and fairness policy is a priority, then the USDA structure should reflect that priority and be empowered with the resources and leadership. The creation of an Office of Special Counsel for Competition and Producer Protection would greatly assist in accomplishing that goal.

### III. Conclusion

There is no credible argument to be made that the livestock markets are working properly. There is no credible argument to be made that the regulatory and enforcement regime is equal to the task before it. Congress should dispense with the past fascination with efficiency as a dominant goal.

Rather, Congress should focus on creating and maintaining a livestock market infrastructure in which all producers, of whatever size, can participate on equal terms without displacement by captive supplies. Congress should focus on market facilitating rules based upon fairness, access,

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<sup>12</sup> Id.

transparency and competition. The access and widespread participation on the internet, the U.S. highway system and the stock markets should be the governing metaphors or analogies.

The proper analysis when balancing market facilitating rules with claims of losses in efficiency is as follows: First, the focus should be on creating a market system that is fair, accessible, transparent and competitive. The internal logic here is separate from efficiency. Second, if efficiency is raised as a negative factor, the following four questions must be asked before balancing the efficiency argument with the anticipated market facilitation effects: (1) Are the claimed efficiency gains/harm real? (2) Are the efficiency gains directly related to the market practice at issue? (3) Is there no other way to achieve the claimed efficiency gains? (4) Are the efficiency gains likely to be passed on to consumers or farmers, or is market power likely to obstruct passing the gains on to others. If the efficiency gains are real, related to the practice at issue, achievable in no other way, and likely to be passed on to consumers/producers, then we can quantify what efficiency gains are relevant and weigh them against the positive effect of the market facilitating rules contemplated.

Legislation should take away the ability for dominant firms to game the system. Captive supplies are the primary mechanism for such manipulation. Rather than requiring proof of past harm, the regulatory approach should look to the incentives in the system. Stated another way, Congress should focus on preventing future harm that is likely to occur because of the incentive and ability to manipulate price or engage in other strategic conduct that would be profitable to a firm but contrary to the public interest.

Thus, the packer ownership ban should be passed. The Enzi captive supply bill should be passed. Any efficiency claims attached to captive supplies are both unproven and eclipsed by the market disruption caused by the practice.

An Office of Special Counsel for Competition and Producer Protection should be created at the undersecretary level within USDA. That office should take over all competition, producer protection, and price reporting functions. That office should also be infused with leadership that can remedy the problems of poor leadership, lack of direction, aimless enforcement, and squandered resources. In doing so, that office can make use of the tools at its disposal including: rulemaking, studies, legislative recommendations and enforcement.

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**STATEMENT OF**

**MR. TIMOTHY BIERMAN  
PRESIDENT  
IOWA PORK PRODUCERS ASSOCIATION**

**BEFORE THE  
SENATE AGRICULTURE, NUTRITION AND FORESTRY  
COMMITTEE**

**HEARING ON PROPOSED BAN ON PACKER OWNERSHIP  
AND  
USDA ENFORCEMENT OF THE PACKERS AND  
STOCKYARDS ACT**

**JULY 16, 2002**

Good Morning, Mr. Chairman. My name is Tim Bierman, and I am a pork producer from Larabee, Iowa. I am the President of the Iowa Pork Producers Association, and I like to joke that in my spare time, I am the owner operator of a hog farm that markets over 10,000 head a year. I also farm nearly 500 acres of corn and soybeans. I am a full time farmer-I derive all of my family's income from this operation. I appreciate this opportunity to present my organization's views on the proposed ban on packer ownership and USDA enforcement of the Packers and Stockyard Act.

The Iowa Pork Producers Association is the oldest and largest state pork producer group in the country. Our organization founded in 1934, actually predates the National Pork Producers Council, and represents well over 6,000 producer-leaders proactively on issues ranging from international trade missions, pseudorabies eradication, ag policy and environmental regulation. Our organization also represents an economic engine in the state of Iowa, providing over 86,000 jobs in the state and contributing nearly \$3 billion in payroll income to our state's residents. If you look at the total economic impact to the state of Iowa, our producers affect nearly \$12 billion in the state.

I would like to state at the outset that our organization represents many different types of operations - from the small operator with 150 hogs to multi-site facilities with capacities in excess of 80,000 animals. Iowa is the largest pork producing state - producing more than a quarter of US production alone. Iowa has held that distinction since 1890. I think as the leader in pork production, we have often been the "trailblazer". One such road we "blazed" is a ban on packer ownership of hogs; Iowa has had one its' books since 1975.

Let's take a moment to reflect on that point, Mr. Chairman. Iowa has had a ban on packer ownership since 1975, and we are still the largest pork producing state in the nation. We have more packers than any other state - with a ban on packer ownership. Another point of interest is that the publicly reported hog market in Iowa is consistently above prices paid in other parts of the country, including the southeast where vertical integration in pork production was born.

In Iowa, we still have some packer competition for hogs and the highest prices in the country. However, Mr. Chairman, I must admit not everyone is pleased with Iowa's approach. I'm sure the committee is aware that Smithfield Foods from Virginia has filed in federal district court against the State to challenge the constitutionality of the ban on packer ownership. A Smithfield executive said their company feels "constantly singled out" and therefore won't build two new processing plants in the state of Iowa. I had never heard of their plans to build new plants until after the lawsuit was filed.

In any event, the Iowa Legislature has amended the ban on packer ownership during two of the last three legislative sessions - and the legislature has voted unanimously both times, affirming Republicans and Democrats faith in the law. In addition to our organization, others supporting the legislative change were the Iowa Farm Bureau and Iowa Farmers Union. For those who point to the proposed ban on packer ownership as a barrier to farmers or the industry, you need not look any further than Iowa to show them the truth.

The truth is that farmers in Iowa demanded the law. Just for some perspective, we polled our members recently on the ban on packer ownership - 92% are still supportive today, and that's an increase from 88% the year before. And as I said before, we represent a vast group of producers - not only owner-operators, but also thousands of contract hog producers. We are the only livestock organization, to my knowledge, which has formally polled their membership on this issue. In fact, we've also heard from a number of Iowa packers who say that they don't want to own livestock.

Now we need to extend that vision throughout the country. A federal ban on packer ownership of livestock is needed because all hog farmers need more competitive markets. I don't operate in a local industry anymore - it's much broader than just Iowa or the Midwest. This hearing couldn't have come at a better time. Producers are worried sick about a return to depression era prices this fall similar to those experienced in 1998 and 1999. Economists are predicting some pretty low prices this fall and those low projections are contingent on all plants maintaining maximum capacity. It's anyone's guess how low hog prices go if we have an unexpected slaughter interruption like a fire, worker strike or packer bankruptcy.

Nonetheless, I have been deeply concerned with some of the debate that occurred as the US Congress discussed a ban of packer ownership during the farm bill debate. I believe the Senate showed leadership in the face of packers threatening plant closures, which by the way Mr. Chairman, I believe was in very poor taste. I am also disappointed that special interest groups -- who say are producer-driven groups -- but align themselves with packers, scuttled the legislation in conference. I believe it was at the expense of typical producers like me. We appreciate your leadership, Mr. Chairman, on this issue, but wish that many of your conference colleagues shared your views.

We realize there can be regional differences of opinion -- I know personally from our organization's work at national delegate meetings. But despite these regional differences, Iowa producers convinced their fellow farmers from across the country to change our national organization's position on a ban of packer ownership from "against" to "neutral" as the (official) policy of the National Pork Producers Council (NPPC). That may not seem a dramatic shift of position, but you have to understand the internal dynamics of the organization to realize this is a major departure from its' past views on this matter.

And why did the delegates to the National Pork Producers Council change their views? Again, because farmers demanded a change in policy -- not the packers, but the farmers. A ban on packer ownership of livestock should not be a game of political football - it's what the farmers want.

There are several reasons the Iowa Pork Producers support a ban on packer ownership of hogs. The obvious reason is that vertical integration controls both the supply and the demand for live hogs. Furthermore, vertically integrated companies can shift profits and losses between slaughtering operations or live hog production, which typical farmers can't do. And finally, vertical integration makes price discovery for live animals almost impossible because the animals are not sold, they are "internally transferred".

I have attached an outline of Iowa's packer feeding law, but I will briefly review what it does and does not regulate. The law in Iowa forbids packers from owning, controlling, contracting for production of hogs, and from financing a hog operation. Marketing contracts are specifically exempted. And the law does not affect unsecured financing for purchases of feed. The law exempts farmer cooperatives and because of the recent Farmland announcement, it would be hard to argue they received an unfair advantage. Finally, the law exempts smaller packers.

This year, the law changed to allow for limited exemptions for new Qualified Processors. The law limits their size of operation and allows for farmers to become equity holders but only up to 10% for each farmer. The entity must be 60% owned by farmers and they must agree to provide 25% of their daily slaughter to non-shareholders by negotiated sales. This approach was also suggested in a October 1999 NPPC press release which stated, "More negotiated sales would help ensure prices reported for the spot market reflect the current value of hogs".

Requiring negotiated sales also ensures that these new qualified processors will provide for public shackle space for all hog farmers. Available shackle space has become critical for independent farmers, because promises of new slaughtering plants will not benefit farmers if the slaughter is only for packer owned hogs and the new plant results in closing another plant. The actual effect could be a net reduction in competition for hogs because of the new vertically integrated slaughtering plant.

Independent pork producers throughout the country need more competitive markets. We urge this committee to give producers the opportunity for success. A federal ban on packer ownership of livestock is needed to increase market competition, shed more light on price discovery and to secure more public slaughter space for pork producers across the country.

Concerning enforcement of the Packers and Stockyards Act, a difficult task continues for USDA's Grain Inspection and Packers and Stockyards Administration (GIPSA). Implementing the federal Mandatory Price Reporting law is a step in the right direction, but continued market oversight is now crucial. In the past, evidence of violations was often missing for GIPSA to be successful in a legal case. However, with mandatory reporting of prices paid by packers, we feel GIPSA now has much more legal ammunition than ever in history. Communication could also be improved on GIPSA's activities. They must communicate clearly their activities in instances when they discover violations as well as when they do not. While we understand implementing the new price reporting law was difficult, it's time to better communicate the behavior of livestock markets.

In addition, there have been some procedural changes within mandatory price reporting that are disturbing for pork producers. One change is USDA's acceptance of all negotiated bids for calculating the simple average of market hog prices. Previously, USDA would exclude extreme bids from extremely small lots for example. While on the surface, including every bid appears to be consistent with the intent of the law; this policy has encouraged what's commonly called "bottom feeding".

Bottom feeding is used not only to lower the average prices paid for negotiated or spot market hogs, but some market contracts specify that the simple average price is the base amount paid before quality premiums or discounts. So in this case, there is a huge incentive to find and report the poorest cash bid. We commented during the mandatory price reporting rules that both the extreme top and bottom prices should be statistically thrown out to avoid this problem, but bottom feeding still exists today. This process affects much more than the actual prices paid, since the average price is also used to calculate some formula priced animals. I have talked to many producers who've lost thousands of dollars on formula based market contracts because of bottom feeding and it affects on the average cash price reporting.

However, one of the best tools of the mandatory price reporting system is the weighted average of prices paid. This takes into account the prices paid and the volume at various prices. If USDA cannot determine how to throw out extreme prices for the simple average, they could mandate the weighted average price be used in certain formula contracts, rather than the simple average price because it is a more accurate reflection of the prices paid for negotiated hog sales. However, USDA could still report the range and simple average for public reporting purposes.

Finally, GIPSA should immediately initiate a federal study and periodic reporting to evaluate the amount of total shackle space and publicly available slaughter space. This should include various regions of the U.S. and throughout North America. Transportation and trade with Canada and Mexico make their plants and ours almost interchangeable. Therefore, they should be included as part of the report.

In closing, IPPA is committed to a fair, transparent and competitive marketplace. Our producer members constantly remind us of our duty. Mr. Chairman, thank you for holding this important hearing and for giving me the opportunity to address the committee. The Iowa Pork Producers Association stands ready to assist you in your work on these critical issues facing livestock producers.

And I've seen first hand the reaction of consumers during our pork store promotions. Most of the time shoppers can't believe I'm a real farmer. Therefore, I believe that consumers in New York, for instance, would rather buy their pork raised on typical farms like mine, rather than from "Acme Meatpacker Incorporated", especially given the lack of consumer confidence in Wall Street. I want you to understand that this is not to call into question the safety or quality of a packer's product, because we work in partnership to provide the safest and most wholesome product in the world. And were it not for the pioneering efforts of some of these companies, there would not be the variety of products available on the market.

**Iowa Pork Producers Association****Captive Supplies in the Livestock Industry**

As early as 1975, it has been unlawful in the State of Iowa for any processor of beef or pork to own, control or operate a feedlot in Iowa in which hogs or cattle are fed. Pork producer leaders in Iowa have expressed concerns for several years. As early as 1981, the association's elected producer leaders developed a policy position that expressed support for continued monitoring of the packer and retail industry. Each year approximately 200 pork producers representing their local county pork producers organizations serve as delegates to the IPPA's annual meeting.

1989 - The delegates passed a resolution calling on the National Pork Producers Council (NPPC) to seek and secure legislation to prohibit packers nationwide from feeding and slaughtering porcine animals.

1994 - The association's board of directors developed a policy statement calling on the Packers and Stockyards Administration to engage in vigorous oversight of the industry to make sure market access is available on an equitable basis to all pork producers, and should specifically study and report on the availability of market contracts which may be used in the industry.

1996 - Several policy statements that are included in the association's policy manual were developed. Delegates to the IPPA's annual meeting passed a resolution which stated, "we support reporting the pork industry's percentage of captive supply by the Agricultural Marketing Service and the Packers and Stockyards Administration". Another resolution passed at that meeting states, "we believe Iowa's prohibition on 'packer feeding' should be vigorously enforced by the Iowa Attorney General so that pork processors are not allowed to operate feeding operations in Iowa and that Iowa's packer feeding law should be amended to prevent processors and those who own processors from circumventing the law by simply establishing new corporate entities which they control".

1999 - Delegates to the IPPA annual meeting passed the following statement, "We encourage the IPPA and NPPC to look into the preservation of competition in accordance with the Sherman Anti-Trust Act within all aspects of the industry". At the IPPA Board of Directors meeting in August 1999, a policy statement was approved calling on pork producers to sell at least 25% of their hogs on the open market and to report the prices to the USDA Market News Service.

IPPA assisted with the passage of mandatory price reporting. In Iowa, mandatory price reporting laws were passed in 1999. The federal mandatory price reporting law and rules were passed by Congress and signed by the President during 1999-2000.

1999 & 2000 - IPPA assisted with amending Iowa's corporate farming laws. The 1999 legislation was used to bring suit against a packer by the Iowa Attorney General. Without these changes, the state would not have had a legal basis or reason to be in court ("legal standing").

2000 - Delegates directed the association to support federal legislation that bans packer ownership, excluding closed cooperatives, of hogs or cattle, directly or indirectly.

2002 - Legislation rewrote and strengthened the vertical integration prohibition against packer feeding of swine. This legislation closed a loophole which indirectly allowed packer/processors to own or finance pork production. The law prohibited the activity and required divestiture if packers had indirectly financed pork production. Both the 1999 and 2000 legislation were at the direction of and consistent with IPPA producer delegate policy.

**Statement of Mr. Nolan Jungclaus  
Before the Senate Agriculture, Nutrition and Forestry Committee  
July 16, 2002**

Mr. Chairman, thank you for holding this hearing concerning the ban on packer ownership of livestock and USDA enforcement of the Packers and Stockyards Act. My name is Nolan Jungclaus. I am a grain and livestock farmer from Lake Lillian located in central Minnesota. I raise 450 acres of crops, 80 of which will be certified organic this year, consisting of corn, soybeans, wheat, oats, alfalfa/sweet clover, sweet corn, and peas. We also have a small farrow-to-finish hog enterprise based after the Swedish deep straw production system in which we raise up to 600 head per year of antibiotic-free pork.

This has not always been the case. In 1994 our farming operation made a major transition as a corn and soybean grain farm that is typical in our area to a more diversified and sustainable farming business. Through the introduction of a livestock enterprise and the diversification of cropping systems, we have been able to improve farm efficiency and profit despite the currently depressed farm economy. My affiliation with Minnesota Farmers Union, the Land Stewardship Project, and the sustainable agricultural programs offered through the Minnesota Department of Agriculture has helped our family recognize the very positive social, economic, and environmental impacts that our farming operation has on our local community.

I have changed as just a commodity producer, who would otherwise be another statistic in the declining rural economy, to a board member of the Prairie Farmers Cooperative, to an innovative 5.8 million dollar hog processing plant in rural Dawson, Minnesota. The Co-op is owned by 82 local family farmers and processes approximately 65,000 hogs annually, thus allowing us to stay on the land, capture more market value, and reinvest some of that value back into our community. Our enterprise has spawned new growth and opportunity for our community. At full capacity the plant employs 65 people at good-paying jobs in Lac Qui Parle County, a county that has been experiencing an exodus of farmers and rural residents as a result of the dire rural condition.

Since the transition of our farm in 1994, I have witnessed ever-increasing vertical integration in the livestock industry. A concentration of economic power and wealth spearheaded by packers who own and feed their livestock. This shift in the economic balance from the rural sector to the corporate headquarters of the very large and monopolized packing industry is sucking the lifeblood out of our rural communities.

My understanding based on articles I've read from *Successful Farming* magazine, is that the six major packers - Smithfield, Premium Standard Farms, Cargill, Tyson, Hormel, and Farmland - owned more than 1.2 million sows in 2001. Based on my knowledge and experience of raising hogs, that results in more than 30.4 million packer-owned market hogs per year. This means six packers on average slaughter about 120,000 of their own hogs *every day*. U.S. hog slaughter consisted of approximately 98 million head in 2001. One third of

those are owned by six packers and that is only counting the hogs they raised farrow to finish.

The number of sows owned by packers has tripled since 1996 when, according to the same article, these six pork packers owned 442,000 sows. I don't believe it is coincidental that the hog farmer's share of the pork retail dollar has plummeted from 42 and a half cents in 1996 to 30 cents in 2001- a significant drop of 29%. That is money taken out of my pockets, money that is not circulating in my community, and it is hurting us severely.

According to a report by the University of Missouri, only 17% of hogs are sold in the open market – the rest are either packer-owned or under long-term contracts that are neither public nor open to bid and are routinely offered to only the largest operators. However, even that 17% is misleading because many hogs are sold where there is only one packer in the market. Some experts are saying that 3% of the hogs sold in Iowa and southern Minnesota are setting the price for everyone.

The corporate greed we are reading about daily in our news media has many faces. Stealing, whether it is through creative accounting or manipulating markets, is an unethical practice that is undermining our nation and our national security. As the cliché goes, you can dress a pig in pretty clothes, but it's still a pig.

Packer ownership and captive supplies means minimal demand for our hogs. We get a lower price because packers are filling demand with their own hogs. We can participate in the market only after packer-owned hogs and those they have on long-term secret contracts have been used. They then offer a "so-called" price - one below market value - that in effect steals our hogs. This is not the working of a competitive market. It's a racket that is killing the roots of our society and undermining the fabric of free access to opportunity for farmers and all Americans in the rural sector. It leaves us with a very bad taste in our mouths about corporate greed, and the unwillingness of our government to do anything about it. It teaches our young that individual enterprise and opportunity doesn't apply to those involved in agriculture and instead they better tow the line and become a cog in the system.

The Senate did the right thing in November, and then again in February by passing the packer ban. I know that the industry lobbyists are working overtime in DC to kill the packer ban. And now we hear some people say that what we really need is a study. In the rest of America, we see a "study" for what it is – a corporate-generated stall tactic. A study will do nothing for family farmers while allowing the packers the opportunity to control the rest of the hog industry and an increasing share of the beef industry until there is nothing left for the American farmer except raising the owner's livestock for them on contract.

I don't need a study to tell me the effects concentration has on Lowell Petterson who owns and operates the local hardware, plumbing and heating shop in Lake Lillian, the same man who fixes our church's boiler and never sends a bill. I don't need a study to see the impact that consolidation has on Bob Hall who owns our local gas and grocery store and is forced to live on ever tightening margins as packers and large retailers work together to eliminate competition. And I don't need a study to show me that the hardships our local businesses

face directly impact our church offerings and the tax base that supports our schools and hospitals. It is time to take action and pass the ban on packer ownership of livestock.

We already have a very good example in this country of what happens to producers when packer ownership and contract production takes full control of a market - that is the poultry sector. Once contracts become widespread in local concentrated markets, farmers lose all autonomy over the production decisions on their farm. They lose any ability to negotiate the terms of their contract, and they lose the ability to speak out about their situation for fear of retaliation from the corporation that controls their livelihoods. This is exactly what's taking place in the poultry sector, and we need to take steps to ensure that hog producers don't go down that same road.

Our elected representatives must take responsibility to ensure that democracy works for the greater good of all Americans. The path we are on is leading us in the wrong direction. Packer ownership of livestock creates unfair competition, market manipulation, and a vertically-integrated system in which producers become serfs to corporations. Let's get back to the basics, like our Congressional leaders did in the 1920's when they passed the Packers and Stockyards Act. The Act worked until our leaders lost the political will to enforce it. I urge Congress to revive the will to strengthen and enforce the Packers and Stockyards Act.

Additionally, Congress should pass legislation that requires marketing contracts to be bid on an open and public market. Secret deals between packers and the largest producers lead to many problems, including the pervasive sense of unfairness and the opportunity for corruption. Independent producers know that when they sell their hogs for 32 cents a pound, the huge operations with the sweetheart deals profit from inflated prices for their hogs of comparable quality. Legislation that has been introduced by Senator Enzi would require marketing contracts to be traded in open, public markets, such as an electronic market, in which all buyers and sellers could have access. We have the technology and funding provided in the Rural Development Title of the recently-passed farm bill to make this happen. This legislation would establish an open marketing system and allow farmers to compete and ultimately profit in livestock production. Senator Enzi's amendment preserves the benefits of forward contracts and marketing agreements, while eliminating unnecessary characteristics of current contracts that can cause price manipulation and price discrimination.

Mr. Chairman, I urge Congress to uphold the principles that made this nation great. Passage of the ban on packer ownership of livestock, enforcement and the strengthening of the Packers and Stockyards Act, and Senator Enzi's legislation addressing captive supply will help restore competition to farmers and reinforce the pillars of democracy.

Thank you for the opportunity to testify. I would be very glad to answer any questions the committee may have.



**Statement  
of the  
American Farm  
Bureau Federation**

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**TO THE  
SENATE AGRICULTURE, NUTRITION AND FORESTRY COMMITTEE  
REGARDING  
MEATPACKER OWNERSHIP OF LIVESTOCK**

**Presented By:  
Steve Appel, Vice President  
American Farm Bureau Federation and  
President of Washington State Farm Bureau**

**July 16, 2002**

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*As the national voice of agriculture, AFBF's mission is to work cooperatively with the member state Farm Bureaus to promote the image, political influence, quality of life and profitability of the nation's farm and ranch families.*

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**FARM BUREAU** represents more than 5,000,000 member families in 50 states and Puerto Rico with organizations in approximately 2,800 counties.

**FARM BUREAU** is an independent, non-governmental, voluntary organization of families united for the purpose of analyzing their problems and formulating action to achieve educational improvement, economic opportunity and social advancement and, thereby, to promote the national well-being.

**FARM BUREAU** is local, county, state, national and international in its scope and influence and works with both major political parties to achieve the policy objectives outlined by its members.

**FARM BUREAU** is people in action. Its activities are based on policies decided by voting delegates at the county, state and national levels. The American Farm Bureau Federation policies are decided each year by voting delegates at an annual meeting in January.

**STATEMENT OF  
THE AMERICAN FARM BUREAU FEDERATION  
TO THE  
SENATE AGRICULTURE, NUTRITION AND FORESTRY COMMITTEE  
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MEATPACKER OWNERSHIP OF LIVESTOCK**

**Presented By:  
Steve Appel, Vice President  
American Farm Bureau Federation and  
President of Washington State Farm Bureau**

**July 16, 2002**

Good morning. My name is Steve Appel and I am Vice President of the American Farm Bureau Federation and President of Washington State Farm Bureau. I am from Whitman County, Washington. I appreciate the opportunity to present testimony today on behalf of the American Farm Bureau Federation on packer ownership of livestock.

Increased concentration in agricultural markets has frustrated many farmers and ranchers because producers believe increased concentration results in less market competition. Less market competition means less price transparency and can often result in lower prices. At the packer level, the four largest firms' share of hog slaughter has reached 59 percent, compared with 40 percent in 1990. It is estimated that in 2001 over 80 percent of all hogs in the U.S. were marketed through some form of forward sales arrangement between the producers and packers. Approximately 25 percent of all market hogs in the U.S. were either partially or entirely owned by a packer.

In the cattle sector, the four largest beef packers account for 81 percent of all steers and heifers slaughtered today, compared with 36 percent in 1980. The USDA captive supply report released earlier this year found that 25 percent of the U.S. beef supply was captive supplies of the packers.

AFBF believes prohibiting packer ownership of livestock would reduce concentration and allow independent producer more access to a competitive marketplace and price discovery. Allowing packers to stay out of the cash market for extended periods of time reduces farm gate demand. The result is reduced market access for small and medium-sized producers.

In recent years many livestock producers have engaged in various marketing arrangements with packers to assist in profitability, consistency in product and guaranteed marketing of product. Such arrangements provide a premium for the producer and a certain delivery date for the packer. Farm Bureau supports the ability of producers to forward contract, participate in grid and formula pricing and other risk management tools, but believes that allowing packers to own livestock reduces competition in the marketplace. We worked diligently with staff members during the farm bill debate to

clarify the issue of control and supported the language included in the Senate-passed farm bill which would have allowed risk management tools for livestock producers.

There are many questions and concerns regarding the prohibition of packer ownership. Those opposed question the ability of the packers and retailers to continue the excellent and diverse product development and marketing of livestock products that has resulted in increased demand both domestically and internationally. There is strong demand for case-ready and other products. Since there is such strong demand for these products, their development will continue regardless of whether the prohibition of packer ownership becomes law.

Another argument against the prohibition of packer ownership is that the poultry industry would have a further competitive advantage over the pork and beef industries if packer ownership would be prohibited. Poultry and beef are two completely different types of protein. If there is currently a competitive advantage for poultry, we believe it is mostly attributed to product development and case-ready meat that can be easily prepared. The beef industry is developing products that are easily prepared and working with the retail industry to meet the demand for a more diverse and user-friendly meat case at the grocery store.

There are also concerns about the present availability of carcass data currently available used to further improve production management. Improved carcass data is assisting producers to meet the livestock specifications needed by the packers. The availability of that information should not diminish as a result of a prohibition on packer ownership.

Many buyers and sellers characterize a truly competitive market. Concentration in agriculture is increasing. When the numbers of buyers is reduced, downward pressure on price may result. As marketplace volume decreases, the market is far more susceptible to intentional or unintentional actions taken by the dominant buyers. If a plant shuts down or a packer pulls out of the market for other reasons, prices suffer. There is increasing concern among producers, due to the downturn in the economy and companies filing for bankruptcy, that some packing plants may shut down. Reduced slaughter capacity typically means lower prices for producers.

The Packers and Stockyards Act (PSA) was enacted to deal with the problems associated with concentration. Its regulations prohibit sale barns or auction markets from vertically integrating. Specifically, stockyards may not own or control buying stations, packing plants or livestock feeding operations. The rationale is that such ownership or control creates conflicts of interest, access problems for other producers, and opportunities for self-dealing which distorts the market. The procurement of cattle and hogs has changed dramatically since the Packers and Stockyards Act was passed over 80 years ago. At that time, cattle were primarily sold at auction markets to the packers. Today, most cattle are sold directly off the feedlot to the packing plant. Farm Bureau believe that because the meatpackers are similarly situated to stockyards as a market creator and market forum, the same rules in the PSA should apply to them. In fact, more concentration exists today among the packing industry than existed at the time PSA was originally passed.

The prohibition of packer ownership of livestock is a passionate and controversial issue. Such a ban will not solve all of the issues of livestock concentration and cyclical price fluctuations for producers. However, it may assist independent producers in securing a competitive marketplace and a transparent price discovery system. There are many questions to be asked regarding livestock concentration and how to achieve a fair, competitive marketplace for all segments of the industry from producer to retailer. We appreciate the hearing today and the opportunity to discuss this important issue with the Committee.



**Testimony of J. Patrick Boyle  
President and CEO, American Meat Institute  
Before the  
Senate Committee on Agriculture  
July 16, 2002**

Thank you, Sen. Harkin, Sen. Lugar and members of this committee for inviting the American Meat Institute to testify here today. AMI is the nation's oldest and largest organization representing meat packers and processors, whose business practices are governed not only by the Sherman Act, the Clayton Act, the Robinson-Patman Act and the Uniform Commercial Code, but also by the Packers and Stockyards Act, a statute unique to our industry that clearly prohibits meat packers from engaging in unfair or deceptive business practices that disadvantage their livestock suppliers. To my knowledge, there is no other sector of the U.S. manufacturing or service economy in which government plays such a watchdog role with respect to raw material suppliers.

And yet, ironically, as my industry operates with this additional, daily, government oversight of our business transactions with livestock producers, we are here today to discuss whether meat packers should receive additional scrutiny, enforcement or business restrictions in order to protect or benefit livestock producers.

I must say these topics just never seem to go away. They were around when AMI was founded in 1906 and have persisted now nearly 100 years. Could it be, as some suggest, that our laws are inadequate? Or is our enforcement poor? Or maybe we haven't done a good job pinpointing the real problems and coming up with constructive solutions? I believe the latter is the closest to the truth and, in that regard, commend those who have recommended a thoughtful, reasoned approach of studying the problems in the marketplace and the business models themselves and identifying new solutions -- rather than mandating solutions and then seeing if they work.

Let me try to characterize the environment in which my member companies operate today. AMI members include 250 of the nation's largest and smallest meat and poultry food manufacturers. Collectively, they produce 95 percent of the beef, pork, veal and lamb food products and 70 percent of the turkey food products in the U.S.

AMI's members have one common objective: to produce products consumers will buy. It is the consumer who determines the value of our products, which in turn determines the value of our raw materials. So we must start any discussion with the consumer. Market research tells us that U.S. consumers have diverse tastes and that 95 percent of them eat meat and poultry regularly, so there is room in the marketplace for many different meat and poultry products with many different attributes. We also know that there is a robust global appetite for U.S. meat and poultry products. We now export 9.3% percent of our beef products and 6.9% percent of our pork products, principally to Japan, Mexico and Canada. These exports have grown exponentially in the past decade, in large part because we produce what consumers abroad want to buy.

In order to create the foods people want to buy, AMI's members have done many things, including increased their coordination with livestock producers so that the raw materials comport with consumer demand. This increased coordination has led to increased vertical integration, which has sometimes included complete or partial ownership of some of each packer's livestock supply. Some positive outcomes of this increased coordination may be familiar to you:

**Leaner Beef and Pork for Consumers.** Retailers, meat packers and livestock producers heard loud and clear in the 1980s that consumers wanted leaner meats. Working together, these three sectors accomplished an average 27 percent fat reduction in a serving of beef and a 31 percent fat reduction in a serving of pork. Among the actions taken were: packers and retailers trimming fresh meats to ¼-inch of external fat; hog producers and pork packers working together to develop leaner hogs; cattlemen and meat packers petitioning USDA to create a new "Select" grade for leaner beef; and meat processors developing vast new offerings of low-fat hot dogs, luncheon meats, ham, sausage and bacon products.

**Improved Risk Management Options for Producers.** The volatility inherent to farming and ranching has been reduced for many livestock producers through the increased use of contracted sales with meat packers and many other creative risk management plans. The benefits to farmers were perhaps most vivid during the hog market crash of 1998, when spot market prices for an unanticipated over-supply of hogs dropped to as low as \$9 per cwt. Those hog farmers with contracts had locked into much higher prices for their hogs – generally \$35 and more per cwt. – and were protected from the low market prices. Packers with contracts, on the other hand, were obviously paying far over the market value for their hogs at the time. Both parties to the contract, however, benefited from the certainty provided by a steady, consistently priced, contracted supply of hogs.

Before I leave this topic of the benefits of coordination and even integration between manufacturers and their suppliers in the meat industry, I would just note that this is a trend throughout the manufacturing and service economy. It is driven largely by consumer demand for consistent product quality at the lowest possible price. The demand for low prices has led to fewer and larger retail chains in fields as diverse as home improvement products (Home Depot), video rentals (Blockbuster), food and consumer products (Wal-Mart) and fast food (McDonalds). In fact, these companies not only owe their success to these qualities and business practices, they advertise them to consumers. The consolidation at the retail level has driven consolidation at the manufacturer level – for tools, appliances, consumer goods and food products, among others. The demand for consistent product quality has led many firms to exert greater control over their supply chain. Just ask anyone who supplies products to Wal-Mart or McDonalds what that means: it means you must meet their standards or you can't sell to them. It often means you must subject your products and plants to periodic customer audits. This is the way business is done today – and the meat industry should be no exception.

I note for Sen. Harkin that Iowa is the home to a number of leading vertically integrated manufacturers who dominate their fields. Winnebago and Maytag are two respected firms who've formed numerous vertical alliances in recent years with both suppliers and distributors. And Gateway computers, a dominant home computer manufacturer, has now formed vertical alliances to offer Internet access and other affiliated services and products to its customers. The son of a fourth generation Iowa cattle rancher founded Gateway, by the way. The spirit of entrepreneurship is alive and well throughout this country.

Against this backdrop I have described of businesses trying to compete for the consumer's dollar, I hope you can understand why the American Meat Institute strongly opposes efforts that would make it illegal for meat manufacturers to do what the rest of the global

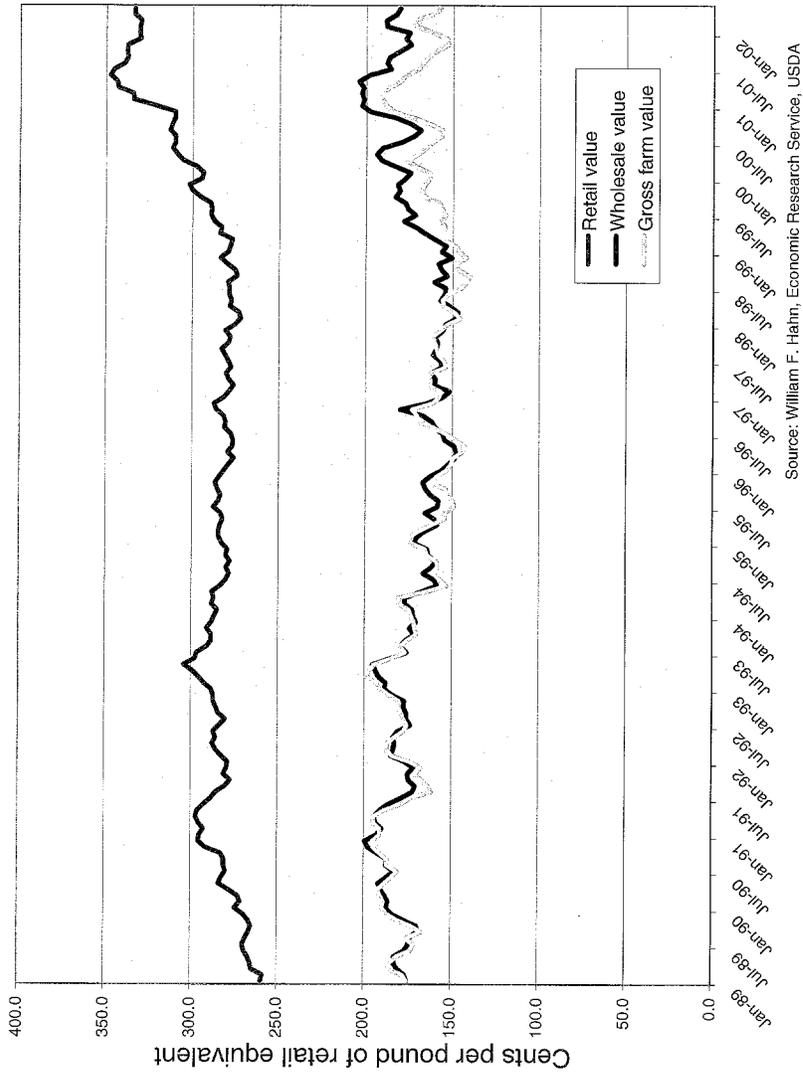
business community is doing, which is to form relationships with suppliers or raw materials in order to produce consistent quality, lowest priced products that consumers will buy. In our view, the proposed ban on packer ownership, control or feeding of livestock would do just that. Further, we will oppose any effort to restrict meat packers who comply with existing antitrust and fair business practice laws from sourcing their raw materials in any way. It is unfair to make it illegal for the meat industry to compete with the poultry industry or any other industry for the consumer's dollar. But let us not forget the ultimate consumer during this debate.

Over the last three decades, Americans have benefited from increasing meat industry efficiency that has made meat more affordable, abundant, convenient and varied. Each year, consumers spend less of their disposable income on meat and poultry. Today, that number stands at 1.9 percent, compared to 4.1 percent in 1970. This is a trend of which we are proud – and one that provides consumers a distinct benefit. We should not rush to undo the foundations of this success without understanding its ramifications for everyone involved.

If there is consensus that the livestock market is not working properly, then we advocate a thoughtful, reasoned, fact-based approach that will help all businesses – farms, ranches, processors and retailers -- pinpoint problems and develop targeted and effective solutions.

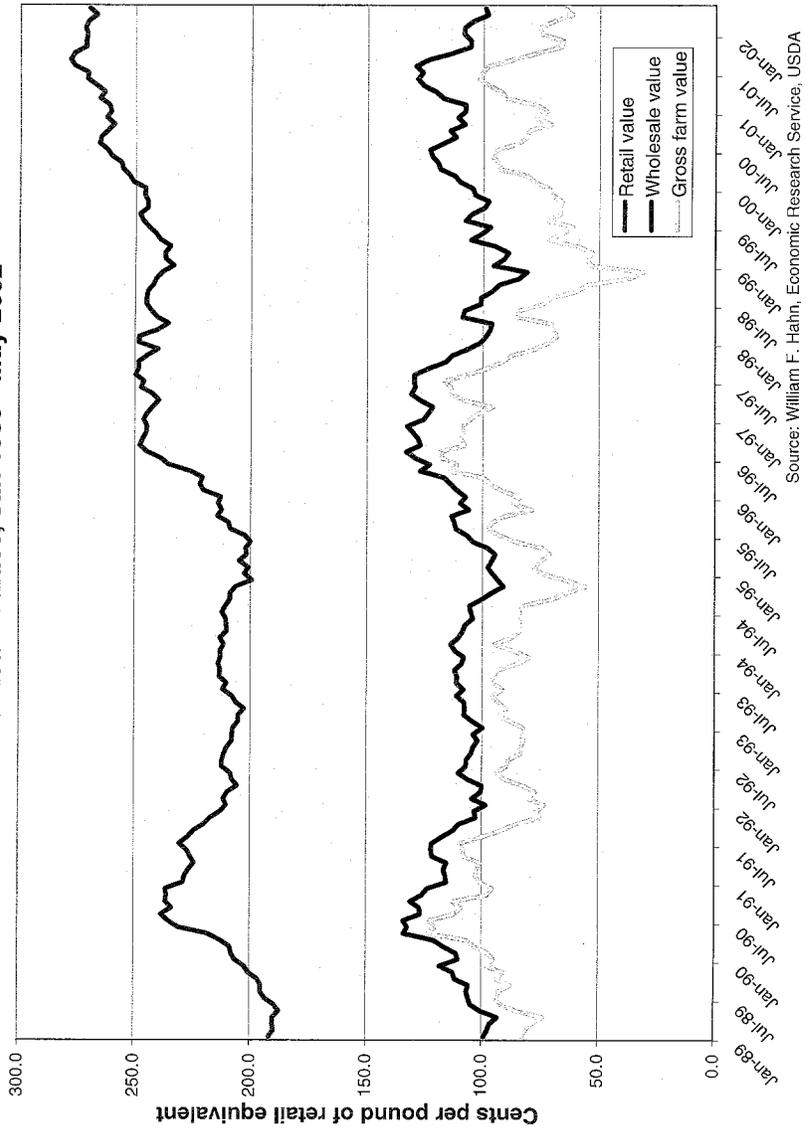
I would be happy to answer any questions.

Choice Beef Farm-to-Retail Values, Jan 1989 - May 2002



Source: William F. Hahn, Economic Research Service, USDA

Pork Farm-to-Retail Values, Jan 1989 - May 2002



Source: William F. Hahn, Economic Research Service, USDA

**Market Structure Issues in the Livestock Industry**

**Testimony to the  
United States Senate Committee on Agriculture, Nutrition and  
Forestry**

Hearing on the Proposed Ban on Packer Ownership of Livestock and  
USDA's Enforcement of the Packers and Stockyards Act

July 16, 2002

by

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## Market Structure Issues in the Livestock Industry

C. Robert Taylor

Thank you, Mr. Chairman and members of the Senate Agriculture Committee. It is my pleasure to present testimony today about needed enforcement of the Packers and Stockyards Act (P&S Act).

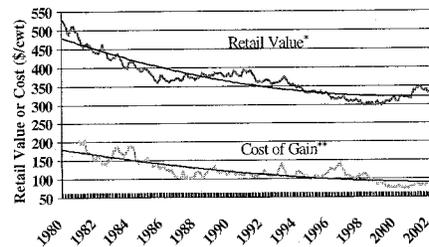
Horizontal concentration combined with vertical integration through ownership or through supply chain management (SCM) has occurred at an unprecedented pace in the beef and pork industries. The massive restructuring of the livestock industry was initially driven by corporate efforts to capture private economic efficiencies, but in the last few years appears to be driven more by efforts to gain market power and economic power generally than by efforts to capture economic efficiencies.

In the past decade, USDA/Grain Inspection, Packers and Stockyards Agency (GIPSA) commissioned several university and ERS researchers to conduct studies as part of their investigation of concentration in the meatpacking industry. My testimony will first focus on USDA data that provide compelling evidence that market power issues now dominate efficiency issues. Then my testimony will turn to discussion of the USDA studies because they continue to be quoted widely by defenders of captive supply and because they appear to be used as a basis for the lack of P&S Act enforcement by GIPSA.

### Overview of Power versus Efficiency

Defenders of consolidation often point to a general decline in inflation adjusted (real) meat prices in support of their argument that consolidation, concentration, and vertical integration are beneficial to consumers. Figure 1 shows USDA estimates of the real retail value for beef by month since 1980. As can be seen, there is a substantial long-term downward trend, to the obvious benefit of beef consumers. However, much of the

Figure 1. Retail Value of Beef and Cost of Feedlot Gain  
USDA and KState data adjusted for inflation, with trend-lines



\*Weighted-average value of retail cuts from Choice yield grade 3 beef  
\*\*Cost of feeding steers in Kansas, expressed in terms of dressed weight

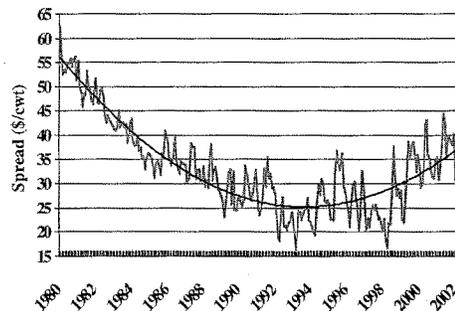
decline in retail prices is not due to increased efficiency in the beef sector, but due to a decline in the real price of cattle feed. Figure 1 also shows estimates of the cost of feeding steers in Kansas, adjusted for inflation<sup>1</sup>. Because the retail value is for selected cuts of meat, while the cost of gain is expressed in terms of dressed weight for the whole animal, the two series are not directly comparable. However, a rough comparison indicates that about 2/3 of the decreased real retail price for beef in the last two decades is due to lower feed prices, and not to efficiency gains in beef production, processing, storage, transportation, and retailing.

Retail prices alone cannot be used to ascertain the effectiveness, efficiency and fairness of the emerging system. The farm-to-wholesale price spread (or margin) and the wholesale-to-retail price spread give insight into whether monopsony (buyer) and monopoly (seller) power are being exerted by meat packers or retailers.

#### Farm-to-Wholesale Price Spreads

Figure 2 shows the monthly farm-to-wholesale price spread for beef, adjusted for inflation using the consumer price index (CPI-U), over the January, 1980, through May, 2002, time period. Also shown in Figure 2 is a non-linear trend-line, which is highly significant statistically. All data, including the CPI-U, are published periodically in USDA's Agricultural Outlook<sup>2</sup>.

Figure 2. Farm-to-Wholesale Price Spread for Beef  
USDA data adjusted for inflation



<sup>1</sup> The Kansas State University data can be accessed at <http://www.agecon.ksu.edu/livestock/Livestock%20Databases/Livestock%20Databases.html>

<sup>2</sup> Net farm value is defined as the market value to the producer for live animal equivalent to 1 lb. of retail cuts, minus value of by-products. The wholesale value is defined as the value of wholesale (boxed) beef equivalent to 1 lb. of retail cuts adjusted for transportation costs and by-product values. CPI-U is the consumer price index for all urban consumers. All inflation-adjusted values are expressed in June 2002

From Figure 2, it can be seen that the farm-to-wholesale (F-W) price spread for beef trended dramatically downward throughout the 1980s and into the early 1990s. A decrease in the F-W price spread is consistent with efficiency gains (lower unit slaughter costs) in meatpacking in a competitive market. That is, in a competitive market, we expect the F-W spread, which reflects gross revenue to packers, to decrease when unit slaughter costs decrease. The trend in the F-W price spread for beef during the 1980s and into the first few years of the 1990s is thus consistent with efficiency gains in meatpacking during that period in a competitive market. As can be seen in Figures 2, however, the trend in the F-W price spread has been strongly upward since the early 1990s, which is a dramatic departure from the efficiency-driven downward trend in the 1980s.

The trend-line F-W price spread for beef in June of 2002 was 50.5% higher than at the bottom of the trend in late 1993. This increase in the F-W price spread reflects a significant increase in the gross revenue to beef packers.

A common argument made by packers to justify the increasing F-W price spread is that they are adding more value. This explanation is easily dismissed for two reasons. First, USDA/ERS calculates the spread for a standard animal so that the spread will reflect only price changes<sup>3</sup>. Second, even if meat quality improves over time, there should be no long-run trend in the F-W spread for given slaughter costs.

Another argument is that the strong upward trend in the F-W spread is due to higher wage rates in meat packing. However, Bureau of Labor Statistics (BLS) data show that the weekly pay for production workers in meat slaughtering plants, adjusted for inflation, was the same during the 1990s as it was during the 1980s. Moreover, the inflation adjusted pay for workers in slaughter plants has decreased somewhat during the last few years.

Meat packers claim that they are realizing efficiency gains by moving to larger and larger slaughter operations. Moreover, they claim that unit slaughter costs are actually less for the leaner animals now produced. Realization of these efficiency gains in a competitive environment would result in the F-W spread continuing to trend downward, not upward as it has in the mid to late 1990s.

The upward trend for much of the 1990s and into 2002 is too strong and too persistent to be explained by short-term spikes in prices, spreads, production, or competition with other meats.

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constant dollars.

<sup>3</sup> "Meat price spreads ... are calculated using a set of fixed retail products. ERS's goal in calculating the retail meat values is to have a measure that reflects only price changes. ERS starts with a standard animal in calculating the beef ... price spreads. This standard animal is cut up in a fixed way at the packing plant, and its wholesale cuts are in turn cut up in a standard way at the retail level." <http://www.ers.usda.gov/briefing/foodpricespreads/meatpricespreads/> accessed on 3/26/2002.

The F-W price spread for beef was analyzed in an article published by USDA/ERS in the June-July 2000 issue of the USDA periodical, Agricultural Outlook. This report noted the upward spike in the F-W spread in the last half of 1999 and compared it to previous short-term spikes in 1980, 1991, and 1995.

After noting that previous spikes were short-term, the USDA report stated:

*“... a long-term increase would be troubling. Increasing concentration in other sectors of the economy has often reflected intense competition and frequently led to falling costs and prices for the concentrating firms. But after an industry consolidates, when few firms face each other in a stable environment, competition may often become less intense.”*

The USDA report concluded by asking the question:

*“As consolidation is completed, will packers successfully limit price competition among themselves and maintain 1999’s high spreads?”*

As can be seen from Figure 2, high price spreads in 1999 have not just been maintained, but they have actually trended upward in the two years since this report was published. Since spikes in the F-W price spread for beef due to exogenous demand and supply shocks normally last only 2-3 months, the answer to the question posed by USDA is that packers apparently limited price competition and maintained the high F-W spreads

In summary, exertion of monopsony or oligopsony power is the only plausible explanation for the strong upward trend in the F-W spread for beef<sup>4</sup>.

#### Wholesale-to-Retail Price Spreads

The Wholesale-to-Retail (W-R) price spread for beef is shown in Figure 3. Unlike the F-W margin for beef, there is no discernible U-shaped long-term trend in the W-R spread, although there is a slight upward trend in the W-R spread.

The W-R spread can be seen to be less volatile in the 1990s than in the 1980s, perhaps due to industry consolidation. In the early 1990s, the W-R spread swung upward somewhat, and then swung downward somewhat in the late 1990s. During the 1990s, the W-R spread for pork (not shown) tended to move in opposite directions from the W-R spread for beef. Such a linkage between the W-R spreads for beef and pork has been explained by joint costing in meat retailing. But even accounting for joint costing of

<sup>4</sup> It has been suggested that the F-W price movements are due to factors such as price dynamics, competition with other meats, production levels, and expansion versus contraction phases of the industry. However, I have done extensive econometric analyses of beef, pork and poultry spreads, including these factors as candidate explanatory variables. Although some of these variables are statistically significant in explaining the F-W spread for beef, the non-linear u-shaped trend remains highly significant in their presence.

beef and pork, there is no appreciable long-term trend in the W-R spread for beef during the 1980s and 1990s. However, the recent upward spike stands in stark contrast to the two previous decades. As can be seen, the W-R spread for beef shot up in mid-2001, taking the inflation adjusted unit gross revenue to beef retailers to unprecedented levels.

The strong upward spike in the W-R spread, which has continued for over a year, suggests that monopoly power has been and continues to be exerted by meat retailers.

Figure 3. Wholesale-to-Retail Price Spread for Beef  
 USDA data adjusted for inflation

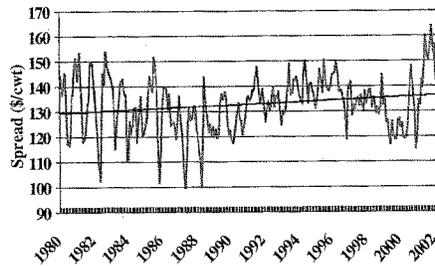
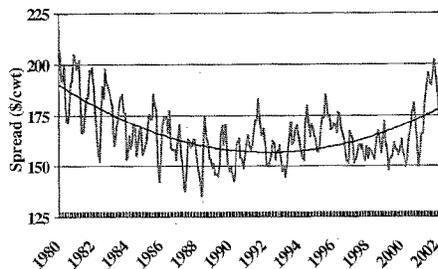


Figure 4 shows the farm-to-retail (F-R) spread for beef. A efficiency driven downward trend in the F-R spread during the 1980s is apparent from this figure. However, the strong upward movement during the last few years apparently due to exertion of monopsony and monopoly power has negated the efficiency gains in meatpacking and retailing that occurred during the 1980s.

Figure 4. Farm-to-Retail Price Spread for Beef  
 USDA data adjusted for inflation, with trend-line



### USDA/GIPSA Captive Supply Studies

GIPSA funded several studies of consolidation, with special reference to the effects of captive supplies<sup>5</sup> on the cash market price for beef. The latest of these studies was authored by Schroeter and Azzam, and is usually referred to as the Panhandle study. Although the GIPSA studies continue to be cited by economists who are defending consolidation and concentration in meatpacking (e.g. Fuez, et al; Ward), it is critical to note that even the most recent GIPSA study used data *only* through mid-May of 1996. The study is thus dated, particularly in light of the strong upward trend in the F-W price spread for beef (Figure 2) which has occurred largely since data for the Panhandle study were collected by USDA.

From an enforcement standpoint, it is troubling that GIPSA has openly “studied” and publicly reported on the consolidation and concentration issues for over a decade, apparently oblivious to a body of antitrust literature on collusion detection. This literature points out that if the firms understand the range of econometric techniques available to the antitrust enforcement authority, then those firms can calculate the limits of undetectable collusion (e.g. Philips, p. 131). So, what GIPSA has done with their highly publicized studies is to inform meatpackers of the issues, the data that will be used for analyses, the econometric techniques that will be used for detection, and what constitutes statistical significance and detectable collusion. Perhaps more troubling is that USDA has not used their authority to obtain potentially richer data sets analyzed with much more sophisticated statistical and econometric techniques.

### Incomplete Data

The Panhandle Study has a technical design flaw that severely limits its potential for addressing the captive supply issue. For analytical purposes, the market for slaughter cattle is national in scope, as was recognized in the latest GIPSA report on captive supply reporting<sup>6</sup>. Yet, the Schroeter and Azzam study was based on data for only four beef slaughter plants, all of which were located in the Texas panhandle. From an econometric standpoint, a national effect cannot, in general, be estimated with data from only for a few packing plants. Thus, conclusions from this study about the aggregate impacts of captive supply on cash market price are questionable.

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<sup>5</sup> Captive supplies are generally defined to be slaughter cattle that are packer-owned or controlled 14 days prior to slaughter.

<sup>6</sup> USDA/GIPSA, Captive Supply of Cattle and GIPSA's Reporting of Captive Supply, Jan. 11, 2002.

## Overlooked Finding in the Panhandle Study

A critical finding in the Panhandle study, which is easily overlooked, is that<sup>7</sup>:

*“... the four Texas plants paid significant quality-adjusted price premia for marketing agreement cattle relative to cattle purchased on the spot market<sup>8</sup>.”*

Quality-adjusted premia for marketing agreement cattle were found to be statistically significant for each of the four plants (two Excel, one IBP and one Monfort). Since marketing agreement prices are generally tied to the cash market price, this indicates that some or all of the captive supply producers may be receiving preferential treatment. A steady stream of unverified information also suggests preferential treatment for some producers.

In economic jargon, the implication of preferential treatment of some of the contractors by packers is that the aggregate supply curve for slaughter cattle is shifted outward, lowering cash market price and thereby harming (discriminating against) independent producers.

The preferential treatment of some producers may allow them to maintain profitability even with lower cash prices. However, independents will be eventually forced out of the business due to sustained losses. The profitability pressure on producers who do not have preferential deals is evident from Figure 5, which shows inflation adjusted monthly cattle feeding return estimates (based on cash market prices) calculated by Kansas State University economists<sup>9</sup>.

Figure 5 also shows a linear trend-line. Note that trend-line returns became negative in 1994, which is approximately when the F-W spread (Figure 2) turned upward. Returns to finishing steers in Kansas averaged \$41.40/head during the 1980s, while returns averaged a negative (loss) \$14.60/head. Premia identified in the Panhandle study are large enough to suggest that contract producers who receive preferential treatment may be making a profit, while independent producers have sustained losses for about eight years.

The long-run implication of preferential treatment of some contract producers is that independents will eventually be forced to exit cattle feeding due to sustained losses. If the beef and pork sectors evolve like the poultry industry we can expect that once the independents are gone, the premia for the remaining cattle feeders will evaporate, leaving them at the mercy of the monopsonistic or oligopsonistic contractors.

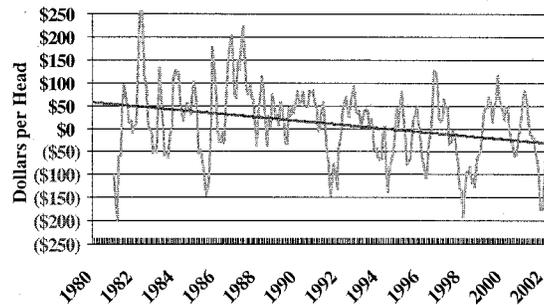
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<sup>7</sup> While the data collected for the Panhandle study are inadequate for econometrically analyzing the effects of captive supply on cash market price, they are appropriate for analyzing the quality-adjusted premia for marketing agreement cattle at the four plants.

<sup>8</sup> Schroeter and Azzam, p. 29.

<sup>9</sup> The Kansas State University data can be accessed at <http://www.agecon.ksu.edu/livestock/Livestock%20Databases/Livestock%20Databases.html>. The variable code is KSYRLCOG in the monthly cattle supply database.

Figure 5. Monthly Returns for Finishing Steers in Kansas  
 Kansas State University data adjusted for inflation



#### Anticompetitive Vertical Integration

Many of the studies of consolidation and concentration in the livestock industry consider potential anticompetitive effects of *horizontal* concentration, but appear to have the implicit presumption that *vertical integration* (or *VSC*) is inherently good because transaction costs are reduced. This narrow view overlooks important literature in industrial economics that establishes conditions under which vertical integration and VSC are anticompetitive.

Hildred and Pinto state:

*“... the thrust of SCM (supply chain management) is accomplished through contractual arrangements that leave intact the independent status of the firms involved. However, several models exist in which firms bend others to their wills and lessen competition through various SCM practices.”*

Contract poultry production is a clear case in point where firms (integrators) bend others (so-called independent contract producers) to their wills (Taylor, May, 2002).

There is substantive theoretical literature that established conditions under which either subcontracting or vertical integration may be privately preferred yet socially inefficient, even in the absence of externalities (e.g. Lyons and Sekkat). In particular, tight vertical relationships, such as those now developing between the concentrated food retailers and the meat packers, have antitrust implications that have not been adequately explored in the Economic Research Service (ERS) or GIPSA studies<sup>10</sup>.

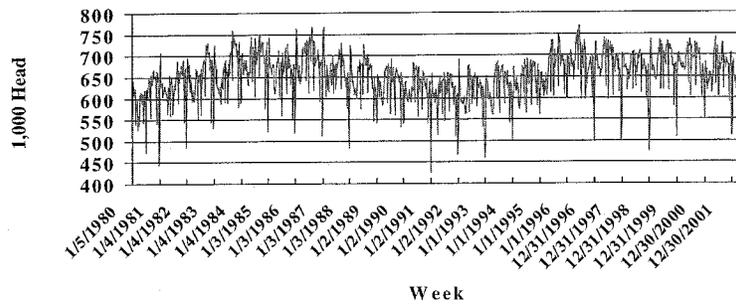
A particularly relevant body of antitrust literature deals with *partial* vertical integration. Although the poultry industry, which fully integrated in the 1950s, is often considered the

<sup>10</sup> See, for example, Chapter 12 in Carlton and Perloff.

poster child<sup>11</sup> for the industrialization of agriculture (Hayenga, Schroeder, Lawrence, Hayes, Vukina, Ward and Purcell; Taylor, May 2002), it is doubtful that the meat packers may not attempt to fully integrate initially because it may not be profitable to do so. Under certain conditions firms (e.g. meat packers) integrate backwards (e.g. into beef production) to satisfy their high probability of demand and use the input market to satisfy their low probability demand (Carlton; Lieberman; Perry). Individual packers may have also used contracts to preempt other packers from accessing a particular supplier (Zhang and Sexton). By partially integrating the firm avoids paying a premium for the input (e.g. slaughter cattle) that is induced by the fluctuating demand of other buyers. Thus, expected total cost of the input to the firm is minimized by partial integration, but not by full integration (Lieberman). Partial integration thereby transfers the risk of demand fluctuations from the meat packer to the partial market that exists after partial integration. Of course, there is the question of how long a partial market will exist if independent producers are forced to exit the industry due to cash prices and increased risks transferred to them by integration.

A textbook justification for vertical integration and contracting of input supply is for the firm to assure itself of a steady supply of the input (slaughter cattle). This is also an explanation often given by corporate executives to explain captive supply in beef and pork. Empirically, however, there is no evidence that aggregate beef slaughter has become more stable with consolidation. Figure 6 shows weekly federally inspected cattle

Figure 6. Commercial Beef Slaughter  
Weekly USDA data



<sup>11</sup> Although the broiler industry by some business executives as a model to be emulated, it should be recognized that not all is well in the poultry industry. See Taylor for discussion of some of the problems due to a lack of transparency in contracting and due to an imbalance in economic power favoring the integrator over the contract producer.

slaughter. Inspection of Figure 6 shows cattle slaughter to be just as variable now as it was in the early 1980s before extensive contracting of supplies. Beef packers could thus “be assured of existing supplies” by simply bidding for them on the cash market.

Many giant agribusiness firms are linked through joint ventures, strategic alliances, partial ownership of competing firms (e.g. Smithfield’s ownership of IBP stock), and tight vertical alliances. While such business arrangements may lead to efficiency gains, they may also compromise competition, perhaps in markets outside the scope of the ventures. The Federal Trade Commission recently released guidelines for examining such relationships<sup>12</sup>.

Perhaps the seemingly unquestioned acceptance of vertical integration can be traced to the training of economists. Hildred and Pinto are generally critical of instructional programs in business colleges, programs in agricultural economics and most textbooks for overlooking the potential negative effects of VSC. They state:

*“... understanding of market structures must be drastically modified to emphasize the existence and exercise of great market power within the food system. New understandings of antitrust policy in vertical relationships are required.”*

#### **Price Determined by Forces of Supply and Demand**

Literature on the meat industries is replete with claims that there are no problems with consolidation or captive supplies because “price is still determined by the forces of supply and demand.” This is a meaningless statement because even in oligopolistic or oligopsonistic industries, the forces of demand and supply largely determine behavior of market participants and thus determine market price. Standard economic textbooks establish that supply of an oligopolist is generally not the same as competitive supply, and that input demand by oligopsonists is generally not the same as competitive input demand. Thus the statement that “forces of demand and supply determine price” is essentially meaningless in an antitrust sense; nevertheless this assertion continues to be widely used.

#### **The Well-Being of Society**

In a book published in the same year—1921—in which the Packers and Stockyards Act (PSA) was signed into law, Professor Frank Knight maintained that the well-being of society depended on maintaining a balance of: (a) economic efficiency, (b) economic power, and (c) economic freedom. He cautioned that the single-minded pursuit of economic efficiency would be at the expense of economic freedom and an economic power imbalance; nevertheless, economic efficiency has come to dominate the thinking of contemporary economists and also come to dominate public policy, including interpretation and enforcement of the PSA and other antitrust legislation.

<sup>12</sup> Federal Trade Commission and U.S. Department of Justice, Antitrust Guidelines for Collaborations Among Competitors, April 2000.

In the last few years, in particular, the efficiency gains from consolidation and concentration in meatpacking are arguably quite modest, yet the economic power imbalance worsens and participation in production agriculture increasingly comes by invitation only<sup>13</sup>, which is a loss in economic freedom.

#### **The Evolution of Markets**

Even Adam Smith, patron saint of CEOs, recognized (in 1776) that there is an inherent instability in a market economy; namely that through natural growth of firms (e.g. Wal-Mart) or through mergers and acquisitions (e.g. Tyson/IBP) that the market system could evolve to monopoly. He added that monopoly would lead to poor management and to higher prices for consumers.

Regulations and enforcement of those regulations are thus necessary for preservation of a market economy. Some global agribusiness firms now have economic and political power exceeding that of many governments. With tremendous economic and political power, and the lack of enforcement of predatory pricing laws, the viability of new firms entering and thereby restoring competition is increasingly a fiction.

Food consumers have historically benefited from efficiency gains and quality improvements resulting from horizontal concentration and vertical integration. But the manifestation of monopsony power several years ago (Figure 2) and now the manifestation of monopoly power as well (Figure 3) have negated efficiency gains realized by beef consumers prior to the mid-1990s. Economic power and market power, and not just economic efficiency, must be a vital part of future studies of the structure, conduct and performance of the food industry.

#### **New Concentration Measures Needed**

New statistical indicators of consolidation and concentration are badly needed. At present, the only statistical indicators reported by USDA generally are crude measures of horizontal concentration, specifically the four or five firm concentration ratios and the Herfindahl-Hirschman Index (HHI). Moreover, these horizontal indicators are computed to reflect ownership, rather than control (Taylor, 1999). New indicators are particularly needed to measure monopsony and monopoly power, economic power, vertical integration, the extent of VSCs, and the extent of collaborations among so-called competitors. Karier has proposed several such measures. USDA could shed considerable light on the extent of consolidation and power by developing and routinely reporting such measures that go beyond the traditional horizontal measures.

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<sup>13</sup> Kinsey notes that participation in the evolving food system is often by invitation only.

### Needed Changes

Although there appears to be a fixation on the captive supply issue, there may be a consensus among academic economists about several problems with the beef industry that USDA could provide leadership in changing. Needed changes to the beef industry include: (a) replacement of the antiquated USDA subjective grading system with objective mechanized and instrumented quality assessment, (b) banning bidding practices which are potential instruments for exertion of abusive market power (Sexton; Connor, Carstensen, McEowen, and Harl), (c) elimination of marketing agreements tied to a cash market in which the contractor is an active participant (Purcell), and (d) providing the same (symmetric) information to both buyers and sellers on a timely basis<sup>14</sup>.

The structure of the present food system in general, and livestock industries in particular, has become quite complex (Kinsey; Sexton). Analysis and enforcement of the P&S Act and other antitrust laws will therefore require agencies charged with enforcing these laws stepping up to a much higher level of theoretical and empirical detection of practices that are unfair, deceptive, discriminatory, and anticompetitive. Furthermore, analysis and enforcement of the P&S Act and other antitrust legislation should not just look at the past, but also be forward looking to ensure preservation of a market economy.

Although the meat and poultry industries are complex and industry changes have historically provided benefits to consumers through lower priced and higher quality meats, there is compelling evidence that anticompetitive practices have recently harmed independent producers and meat consumers. Enforcement of the P&S Act is imperative to prevent further abuses of market and economic power.

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<sup>14</sup> The intent of Mandatory Price Reporting was to provide information to all market participants in a timely and symmetric way. However, as implemented, mandatory reporting has not accomplished this purpose.

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**Market Structure Challenges for the U.S. Live Cattle Industry**

**Testimony**

**of the**

**Ranchers-Cattlemen Action Legal Fund, United Stockgrowers of America (R-CALF USA)**

**Before the**

**United States Senate Committee on Agriculture, Nutrition, and Forestry**

**Hearing on the Proposed Ban on Packer Ownership of Livestock and USDA's Enforcement  
of the Packers and Stockyards Act**

July 16, 2002

Presented By

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Mr. Chairman and Members of the Committee:

I am here today representing the Ranchers-Cattlemen Action Legal Fund, United Stockgrowers of America R-CALF USA. I am a Director of R-CALF USA and I represent the states of North Dakota, South Dakota, and Nebraska. I am also a cow/calf producer, feedlot operator, owner and operator of Herreid Livestock Auction in Herreid, South Dakota, and an auctioneer. R-CALF USA is a national non-profit cattle association that represents only cow/calf producers and independent stockers and feeders. Our mission is limited to representing the U.S. live cattle industry in trade and marketing issues to ensure the continued profitability and viability of U.S. cattle producers.

In 1999, less than three years ago, R-CALF USA moved from a foundation to a national membership organization and is now the fastest growing U.S. cattle association in America, with 1100 new members just since the first of the year. We now have a national membership of over 6000 cattle producers in 42 states. We also have 30 affiliated organizations including 10 statewide cattle associations, 18 county cattle associations, and 2 general farm associations.

Our association's rapid growth is a direct reflection of the growing awareness and concern among U.S. cattle producers for the chronic and severe problems associated with our cattle markets.

I commend Chairman Harkin and this Committee for holding this hearing today. As evidenced by the many individual and joint association letters received by this Committee, cattle producers all across America greatly appreciate the Senate's earlier passage of Senator Johnson's packer ownership ban. Cattle producers also appreciate the Chairman's leadership in working to include the Competition Title in the recent Farm Bill. I am pleased to address the proposal to ban packer ownership of livestock and USDA enforcement of the Packers and Stockyards Act.

#### INTRODUCTION

The importance of the live cattle industry alone, not including the beef processing sector, both to agriculture in the United States and the overall U.S. economy is difficult to overstate. The single largest sector in agriculture for more than 40 years, the live cattle industry currently has more than one million operators and has generated more than \$30 billion in agriculture revenues annually for the last dozen years. During the past several years, however, this vitally important sector of the overall beef industry, and the American economy has been in a state of substantial economic crisis, a condition that persists today. Financially, the live cattle industry overall has incurred more than seven consecutive years of substantial losses.

Our markets are affected by numerous factors from convenience, quality, and consumer trust to export demand, import volumes and supply levels. These are not new to us. What is new, however, is the irrational relationship between both retail prices and packer's boxed beef prices, and our fed cattle price.

Much has been said about the market share beef has lost to competing meats such as poultry, pork, and imported beef and cattle. However, the most damaging lost market share cattle

producers suffer today is the lost share of the consumers' beef dollar from the packers and retailers. No industry segment can continue to survive the losses U.S. cattle producers have sustained. USDA reported in April of 1999 that the nominal farm-to-retail price spread has widened from \$.40 to over \$1.40 per pound since 1970. That is a loss to cattle producers of over \$500 per head – more than the value of calves today.

Some of this loss is normal; it represents cost increases for downstream packers and retailers. But, what we've seen since the early 90s is not normal. In the mid-90s the Cattlemen's Beef Board commissioned Cattle Fax, a leading industry resource for cattle prices and market information, to do a study on price discovery. Cattle Fax reported that historically retail prices and fed cattle prices have moved up and down in close synchrony. The same statement could be made for the relationship between boxed beef values and fed cattle prices. However, neither has been the case since the early 90s.

There is no greater evidence that something is wrong than to witness the record retail prices that you as consumers are paying and the tremendous losses producers are experiencing.

~~There is no greater evidence that something is wrong than the high number of feeders exiting this industry.~~

There is no greater evidence than simply to look at the relationship between both retail and boxed beef prices and fed cattle prices.

The rest of this testimony will reference many reports that help document the loss of producers' market share to the highly concentrated packers through captive supplies.

#### **MARKET STRUCTURAL CHALLENGES**

It is important to note that there are two functioning production models within the U.S. meat industry. The first production model is best represented by the U.S. poultry industry. As stated within the Sparks study commissioned by the National Cattlemen's Beef Association (NCBA) and National Pork Producers Council (NPPC):

“Over time, these independent [poultry] businesses [including independent feedmills, hatcheries, farms, and processors] were combined by “integrators,” who reduced costs by coordinating the production of each stage. As a result, an industry once characterized by tens of thousands of small, specialized businesses became characterized by hundreds of vertically integrated firms. Through horizontal integration, however, the number was reduced to about 50 by the 1990's.”

It is highly questionable whether chicken producers have benefited from this level of integration. In the poultry production model, competitive market signals no longer reach the producer as the integrator dictates both the terms of production and the prices for live birds.

The second production model is best represented by the U.S. cattle industry. Here, the production system is characterized by approximately 1 million independent cattle producers, whose cattle are fed by thousands of independent feeders prior to being marketed to the beef processing industry. When cattle industry markets function properly, consumer driven supply/demand signals determines both the terms of production and prices for cattle. But today our cattle markets are not functioning properly. Instead, the economic power exerted by the highly concentrated beef processing industry upon the live cattle industry is becoming alarmingly similar to the poultry model I just described.

Mr. Chairman and Members of the Committee, I'm here today to tell you that both sides of the packer ownership ban issue can draw upon economic studies to support their respective positions. The beef industry, as indicated by the NCBA's and NPPC's Sparks study, is well underway in its efforts to vertically integrate the feeding sector with the already horizontally integrated processing sector. If this integration is allowed to continue, the outcome will be, like in the poultry model, that fed cattle prices will be determined not by competitive market signals, but rather, by the integrators. Again, the Sparks study admits this outcome when it states **"Vertical integration often attracts investors because of the negative correlation between profit margins at the packing stage and the feeding stage."** ~~The risks that feeding margins~~ may become higher and packer margins lower are the very risks the Sparks study says packers control through captive supplies. The study states, "Thus, efforts to control risk are one of the most important drivers of increased vertical integration and coordination in the meat packing industry." Once our feeding sector is so controlled, the prospects of maintaining an open and competitive market for our cow/calf producers will be lost.

Because it is true that both models are obviously supportable, the challenge for Congress is to do what we citizens have elected you to do – apply our values along with America's vision for our future to today's problems so America will continue looking the way we want it to. The choice between the two models requires no further study. We all know the implications. In the vertically integrated model, production sector profits, along with the profits earned by the industries that support the production sector, are transferred to the integrated sector. This model cannot and will not support the current economic and social infrastructure necessary to support America's rural communities in every state of the Union.

I urge you to choose to promote and preserve an open and competitive marketplace, free of undue influences and manipulation by the packing sector. With this choice, our independent cattle producers will be assured of both economic opportunities and choices within our free enterprise system.

The organizations that brought you the Sparks study are not representing the interests of actual livestock producers. Instead they have brought you a meat processing industry wish list that masks the benefits of moving toward an open and competitive market structure by predicting catastrophic industry losses should packers be prohibited from owning and feeding cattle. This, despite the fact that the data contained in GIPSA's January 18, 2002, captive supply report indicated that the packer fed cattle owned by the four largest firms in 1999 totaled only 2 million head, or about 8 percent of that year's total slaughter.

Despite the obvious and very real concern for economic retaliation by the packers, over 125 independent feedlot owners from the states of Texas, Kansas, Nebraska, and Colorado cosigned a joint letter to each member of the Farm Bill Conference Committee. The letter said, "We the undersigned feedlot operators and feeders urge you to support the packer ownership portion of the Senate version of the Farm Bill." R-CALF USA has promised these feeders that their names would not be publicly released so I cannot share this letter with this Committee. However, the Farm Bill Conference Committee did receive a copy.

Today, the same organization that presented Congress with the Sparks study, replete with admissions that packers are using and enjoying the benefits of captive supplies to help manage their number one input cost - live cattle - are calling upon Congress to conduct yet another study. These opponents to the packer ownership ban argue that no studies have definitively established that packers' use of packer-owned cattle causes cattle prices to fall. As one Kansas feedlot owner recently said, "This is just another big packer stall tactic to keep their unfair profits flowing."

GIPSA, has cited numerous studies indicating a correlation between captive supply volumes, ~~including packer-owned cattle, and cash cattle prices.~~ According to the referenced 2002-GIPSA report, economists Schroeder, Mintert, Barkley, and Jones found a negative statistical relationship between fed cattle prices and captive supplies in 1992; that same year economist Elam found a negative statistical relationship between captive supplies and monthly average fed cattle prices; GIPSA's 1992 study found that packers use captive supplies, including packer owned cattle, strategically; economists Parcell, Schroeder, and Dhuyvetter found that a one percent increase in captive supply shipments was associated with a reduction in basis in Colorado and Texas in 1997; GIPSA, in cooperation with economists Schroeter and Azzam, found a negative statistical relationship between weekly captive supply and the weekly average spot market price in 1999.

These studies, beginning in 1992, are uncontested with respect to showing a negative statistical relationship between levels of captive supply and spot market prices. Where there is disagreement is whether or not captive supplies are the cause of lower spot market prices. Our economists have gone as far as they can go in helping Congress, the Administration, and the industry to identify a correctable problem. If you combine these economists' studies with the admissions contained in the NCBA and NPPC Sparks study describing how packers use packer-owned cattle to minimize their risk, the causal relationship is clearly revealed and you will know what every seller of live cattle in America knows - packers are using their own cattle to depress cattle prices.

GIPSA states in its 2002 report that it may not prohibit packers from using captive supplies without evidence that the use of captive supplies causes harm or is likely to result in the type of harm that the Act was intended to prevent. Yet, according to GIPSA, its own study was conducted without having audited the reporting information submitted by the packers since 1988. This certainly raises the question of whether GIPSA or any other researcher has access to the critical information needed to determine the extent of harm that captive supplies are inflicting upon the competitive marketplace.

But while USDA is unable to determine if packers are unduly influencing the market, as early as 1999, it was clear to then-Chair of the International Trade Commission Lynn M. Bragg, who said, "The concentration of packers increases the packers' leverage relative to cattle prices." Fellow ITC Commissioner Carol T. Crawford wrote in the ITC's November 1999 Final Determination on Live Cattle from Canada, ". . . there is considerable concentration in the packing industry . . . which can and does exert influence over prices for cattle." In 1988, Bob Peterson, then Chairman of IBP stated:

"Procurement practices are changing and this concerns me. There is a quiet trend towards packer feeding and it is much, much bigger than you think it is. We cannot stand by if the competitive playing field is unlevel. Our competitors are promoting contracts and seeking more. These forward contracts coupled with packer feeding could represent a significant percent of fed cattle at certain times of the year. Do you think this has any impact on the price of the cash market? You bet! We believe a significant impact."

The severity of the problem with our markets has reached catastrophic proportions. The ban on packer ownership will provide immediate relief from the forces that have driven a wedge within our production chain that prevents consumer-driven market signals from reaching live cattle producers. Retail beef prices remain at near record highs; demand for beef is strong; our population is growing; our herd size has fallen to its lowest level in nearly 40 years; our production this year is below the record production year of 2000; and yet, our live cattle prices are at \$62.00, the lowest level since 1998; and our independent feeders are losing more than \$100 per head. A competitive marketplace would not produce these results.

According to the respected Doane's Agriculture Report on October 26, 2001, "The farm-to-retail spread has topped \$1.90/lb – If the spread were in line with normal, current retail prices would translate to live cattle prices in the mid-\$80s rather than the mid-\$60s." Winter Feed Yards in Dodge City, Kansas, reported in December of 2001, "As of November 30, 2001, retail beef prices were 9 percent above one year ago. Fed cattle prices were 18.2 percent below one year ago – this represents a \$300 per head loss to producers."

While we are losing money and equity, packer margins have literally skyrocketed. According to data compiled by the Livestock Marketing Information Center, packer margins climbed 133 percent since 1992. The per head margin for packers in 1992 was \$62.28. In 2001 it was \$145.20. Meanwhile, live cattle producers have experienced shrinking margins, with prices failing to recover even to 1992 levels. According to the ERS, the producers' share of the retail beef dollar in dropped from 56 percent in 1994 to 46 percent in 2001. In May of this year, it fell to 42 percent. This translates to a loss of around \$300 per fed steer. Producers are losing their market share from the packers and retailers at an alarming rate. This is a clear indication that forces other than competition are influencing our markets. (See Attachment.)

The March 2002 report completed by the GAO reminds us that over six years ago, in 1996, GIPSA could not conclude that the cattle industry was competitive. But no action has been taken. The responsibility to act has now been passed to you, our Congress, and we urge you to take decisive action including, the first but important step of preventing the large packers from

owning livestock. The deck is stacked against cattlemen when they are forced to compete against the same packer for feeder cattle that they later have to sell to when their fed cattle is ready for market.

Attached to my written testimony is an issue brief on Senator Johnson's packer ownership ban. Also attached is a chart depicting the relationship between retail beef prices and live cattle prices since 1979. This chart reveals that until 1994, our industry had confidence that consumer-driven retail prices were translating to live cattle prices – both retail and live cattle prices moved in synchrony. But since 1994, the correlation between retail prices and live cattle prices was disrupted and continues to be disrupted today. This radical disruption is evidence that our live cattle prices are no longer responsive to the competitive market signals driving retail prices. Finally, I am including a chart that shows the disparate relationship between live cattle prices and packer margins.

The second issue is that of USDA enforcement of the Packers and Stockyards Act. As mentioned earlier, GIPSA indicated as far back as 1996 that it could not conclude that the industry was competitive; yet, it is the agency charged with guarding against unfair and anticompetitive practices. ~~Producers have become frustrated with the inaction on the part of~~ USDA to take any meaningful steps to address the unprecedented concentration of the cattle processing industry, and to prevent packers from exerting undue and market distorting influences with their captive supplies.

To compound matters, the previously mentioned March 2002 GAO report reveals that USDA has not properly maintained and updated the economic models used by it and the ITC for determining the potential impacts of public policy decisions, trade implications, and structural changes within the beef and cattle industries. Despite the radical structural changes that occurred within our market structure since the 80s, including the concentration of the packer sector and the use of new tools like forward contracts and marketing agreements, USDA has not properly re-estimated, documented, or validated its models, and much of the data used in the original estimation was from the 1960s and 1970s.

The GAO said in regard to a 1996 ERS study of the causes and effects of consolidation and concentration in the meat packing industry, "While this analysis did not support conclusions about the exercise of market power by beef packers, even though no other manufacturing industry showed as large an increase in concentration since the U.S. Bureau of the Census began regularly publishing concentration data in 1947, it also concluded that the models need to be improved to more fully incorporate relevant determinants of company behavior." But the models were not improved.

The GAO said of the ITC models that neither type of model used by the ITC ". . . is detailed enough to project cattle prices or address the effects of structural changes associated with market concentration, marketing agreements, and forward contracts in the cattle and beef industries." It said the primary model used by USDA is equally deficient.

How can Congress or the industry reasonably rely upon USDA to properly assess and then address the impacts of captive supplies, packer concentration, and growing volumes of both beef

and live cattle imports when it has for so long neglected the analytical infrastructure needed to make such critical assessments and take such needed enforcement action?

This long-term regulatory neglect has rendered USDA ineffective in addressing today's cattle industry challenges. This is not unlike the regulatory neglect now being blamed for the significant shareholder losses caused by the inappropriate conduct of companies like Enron and WorldCom. Our live cattle industry is silently suffering the same consequences – in the form of lost money and equity in our rural communities where our one million producers, our thousands of feeders, and all their supporting industries reside.

Importantly, consumers are being equally harmed by this neglect, as they have not realized any economic savings from the significantly lower prices packers are paying for cattle. In the months of April and May of 2000, a record-breaking production year, Choice retail beef prices were \$3.07 per pound and fed cattle prices were \$.72 per pound. During the same period this year, production was down 2 percent below 2000, Choice retail beef prices increased to \$3.30 per pound and fed cattle prices fell to the mid-\$.60s. Where are the consumer benefits from this market structure?

USDA has demonstrated its ineffectiveness in regulating the major packers. Unlike cattle dealers and sale barns that are closely regulated by the Packers and Stockyards Act, packers are not required to compensate parties they have injured. The Act also doesn't provide for legal fees in a civil action when a packer is found to have broken the law. So even though the USDA was successful in their recent Farmland/National retaliation case involving the Callicrate feedyard, Callicrate was not compensated for his damages, he continues to be boycotted, and has now decided to close his feedyard after feeding cattle for 24 years. New rulemakings could correct these problems.

U.S. cattle producers have become so frustrated with USDA's inaction that they are seeking relief from the judicial branch of government. I am a plaintiff in the pending class action lawsuit, Picket versus IBP. I am also involved in the recent class action lawsuit stemming from USDA's misreporting of boxed beef prices last April. While USDA was misreporting boxed beef prices, all four of the major packers kept bidding artificially low prices for live cattle. We believe the packers who were selling the boxed beef were fully aware of USDA's mistake, yet they continued to underbid for cattle. As soon as the mistake was publicly announced, live cattle prices rebounded \$2-\$4 per cwt. U.S. feeders, backgrounders and cow/calf producers lost millions as a result of this incident. USDA took no action to assist producers. Farmland/National, the fourth largest packer, has already voluntarily offered compensation to its suppliers. The other three packers have not. When packers behave this way, doesn't this conduct ring of insider trading?

#### RECOMMENDATIONS

R-CALF USA firmly believes there is ample evidence that our markets are not functioning according to competitive market fundamentals. We are convinced that the use of packer owned cattle and other captive supply sources are the tools used by the concentrated packing industry to strategically disrupt the competitiveness of our markets, and, we are convinced that the problem

has grown beyond the capabilities of USDA to address. We, therefore, believe Congress should immediately take the following steps:

1. Prohibit packers from owning livestock.
2. Conduct an immediate investigation into the additional cause or causes of why our markets are unresponsive to competitive market signals. Include the following issues as topics for the hearings held in conjunction with the investigation:
  - a. Senator Mike Enzi's captive supply amendment that would require a fixed base price in formula contracts and would require contracts to be traded in open, public markets.
  - b. Packers' use of imports and their affect on the cattle market in light of then-ITC Chair Lynn M. Bragg's 1999 statement that packers are using imports to suppress domestic live cattle prices.
  - c. Interstate shipment of state inspected meat, along with the need to establish minimal performance standards, so state inspected packing plants can expand their presently constricted marketing area.
  - d. Restricting use of the USDA quality grade stamp to only meat derived from animals born, raised, and slaughtered in the United States.
  - e. Need for increased price transparency in cattle markets.
  - f. Needed reform of the Commodities Future Markets.
3. Re-introduce the Agriculture Competition Title including the following provisions:
  - a. Establishment of an Office of Special Counsel for Competition Matters, whose duty would be to investigate and prosecute violations of the Packers and Stockyards Act.
  - b. Provide for the appointment of outside counsel for claims arising from the Packers and Stockards Act.
  - c. Prohibit unfair or deceptive acts or practices in agricultural commerce.
  - d. Porhibit confidential contracts.
  - e. Provide for recovery of attorney fees to enforce the Packers and Stockyards Act.
4. Direct USDA and ITC to update and improve the economic models used to explain and forecast cattle and beef prices, and provide assistance to through necessary funding.

R-CALF USA distributed a joint letter calling for an immediate Senate Judiciary and Agriculture Committee investigation into the functioning of the U.S. cattle market. Originally, 27 local, state and regional cattle associations joined R-CALF USA in calling for this investigation on June 18, 2002. Since that time, many more cattle, general farm and consumer organizations have joined onto the letter. I would like to hand each of you a copy of this updated request.

Let me close by saying the producers in North Dakota, South Dakota, Nebraska, and many other western states are suffering from a severe drought. My grandfather weathered droughts in South Dakota because he had a competitive market with which to recover a fair value for his cattle. The last severe drought we went through in our state was 1988. We culled our herd and sold cull cows for \$50 per cwt. Retail beef prices that year were \$2.50 per pound. In today's drought we are selling our cull cows into a market that will only return \$35 per cwt (\$180 less per head than in 1988). But today's retail beef prices are \$3.31.

America's cow/calf producers, independent stockers and feeders, and consumers are being unjustly excluded from the benefits our free market economy promises. I respectfully urge this Committee to immediately and decisively remove the known barriers preventing our participation.

Thank you for your consideration.

Attachments: 3

**R-CALF USA POSITION BRIEF**  
**Packer Ownership Ban**  
**March 1, 2002**

**Background:** R-CALF USA's members adopted a policy in February 2001 supporting a ban on packer ownership of livestock for more than 14 days prior to slaughter with the exception of plants that process less than 100 head per day. On April 2001, and again in July 2001, R-CALF USA testified before U.S. Senate Agriculture Committee Hearings asking Congress to include this policy in the Farm Bill.

On February 12, 2002, the U.S. Senate passed an amendment prohibiting packer ownership of livestock. It was known as the Johnson-Grassley amendment as amended by the Grassley-Harkin amendment.

**What the Packer Ownership Prohibition Will Do:** The final packer ownership ban (Amendment) in the Senate Farm Bill prohibits packers from owning or feeding livestock directly, through a subsidiary, or through an arrangement that gives the packer operational, managerial, or supervisory control over the livestock, to such an extent that the producer is no longer materially participating in the management of the operation. This means that the largest packers cannot participate in poultry-style grower contracts whereby producers become more like an employee of the packer rather than an independent livestock producer.

Farm cooperatives that own livestock are exempt from the Amendment. Also exempt are packers that slaughter less than 2 percent of the national slaughter (about 2,850 per day). Beef packers must comply with the Amendment within 180 days after the Farm Bill is signed by the president.

**What the Packer Ownership Prohibition Will Not Do:** The Amendment will have no effect on forward contracts, future contracts, alliances, or marketing arrangements so long as the producer maintains both ownership and management control over the livestock and the production operation. Further, the Amendment will have no effect on cooperatives and no effect on packers that slaughter less than 2 percent of the national slaughter. Based on year 2000 slaughter, only packers that slaughter more than 712,600 head of cattle per year, or 2,850 head per day (assuming 250 slaughter days per year) would be subject to the Amendment.

The Amendment affects only the packer-owned portion of captive supplies, not contracts. Packers subject to the ban on livestock ownership will still be able to procure cattle through such captive supply arrangements as forward contracts, marketing arrangements, and alliances. Some alliances may have to be reworked in order to comply with the Amendment. If, for example, a packer that slaughters more than 2,850 head per day participates in an alliance wherein it either purchases feeder calves directly from a producer, or it assumes managerial or operational control over the livestock during the feeding process, the packer would have to adjust the alliance to conform with the Amendment. Many options would be available to the packer, including contracting with producers or an independent feeders to deliver a certain number of cattle meeting specific quality criteria. There is no reason that producer beneficial alliances cannot be established that provide opportunities for independent cattle producers, independent feeders, and packers alike.

**Economic Impact of Act:** We believe that the benefits of the Amendment will be increased competition for cattle, upward pressure on price, more fair access to slaughter space for independent producers and less market distortion. Though the packers have made many claims of loss of equity in the cattle industry, loss of quality control, and loss of the domestic cattle industry, we believe these claims are false.

Rather than experiencing a loss of equity as argued by the packers, the cattle industry would experience an increased infusion of equity into the production chain. This increase will result from packer purchases

of the same number of cattle, but at a higher cost because they will be buying heavier fed cattle, not lighter feeder cattle. The packers business is to slaughter cattle. The number of cattle they slaughter depends on retail demand for beef. The packer ban will only change how packers procure the cattle needed to satisfy retail demand. It will require packers to purchase all their fed cattle from feedlots or independent feeders. This will create an increased demand for fed cattle. As a result of this increased demand for fed cattle, feedlots and feeders will have to aggressively buy more feeder cattle from independent producers in order to place enough cattle on feed to satisfy the packer's demand for enough beef to satisfy retail demand. It is our belief that this is the very essence of our free enterprise system.

Several states have enacted restrictions on packer ownership of livestock or livestock facilities and there has been no evidence of financial injury to either packers or producers in the manner predicted by the packers. These states include some of the nation's biggest livestock states, such as Iowa, South Dakota, and Nebraska.

How many cattle do packers own? In a January 18, 2002 captive supply report, GIPSA estimated that packer fed cattle owned by the largest four packers during calendar year 1999 totaled approximately 2 million head. Based on the four largest packers' 1999 total slaughter of 23.9 million head, packer fed cattle accounted for 8 percent of the year's slaughter. To put this in perspective, the four largest packers owned more cattle in 1999 than the U.S. imported from Mexico and Canada combined in 1999 (The U.S. imported a total of 1.9 million head of live cattle from Mexico and Canada in 1999).

Another way to look at this is that 26 percent of all captive supplies (packer-owned, forward contracted and marketing arrangement procurements) held by the four largest packers in 1999 were packer owned cattle. Thus, if captive supplies in 1999 were even partially responsible for the low \$65.5 per cwt. average fed cattle price in 1999, then packer owned cattle contributed over one-fourth of the overall negative impact caused by captive supplies.

The 1999 data used in the GIPSA report is the latest data available. It is widely accepted by the industry that the percentage of captive supplies has increased over the past two years. It is, therefore, presumed that the impact of packer-owned cattle on the market was greater in 2001 than it was in 1999.

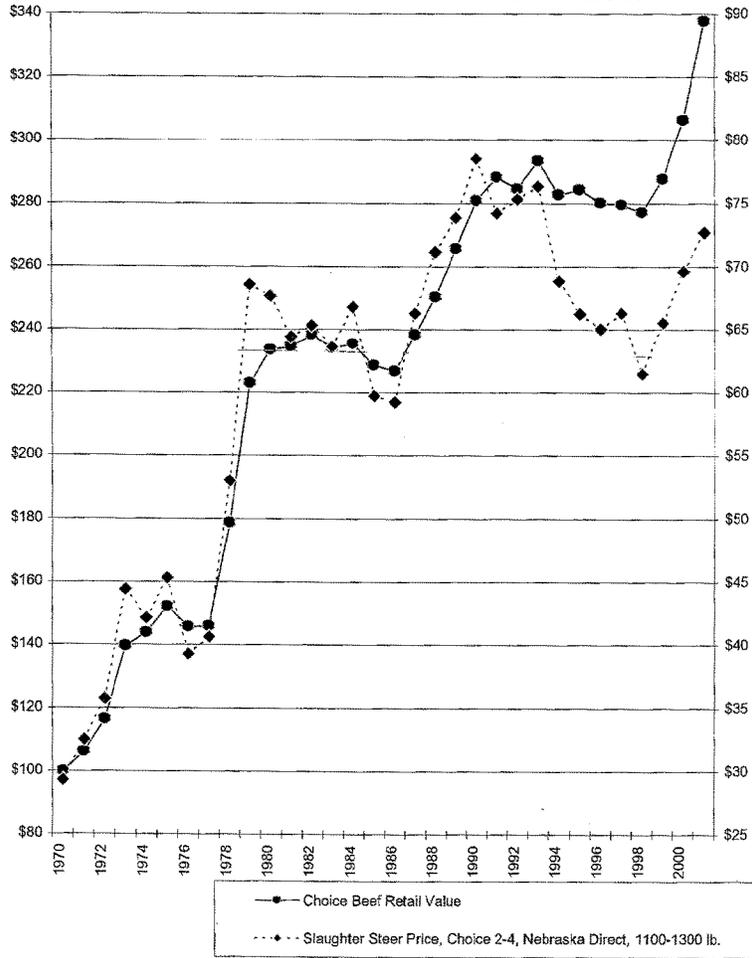
The question then remains: Do captive supplies, including packer-owned cattle, have a negative impact on cattle prices? The January 18 captive supply report by GIPSA acknowledged that, "A negative statistical relationship between the use of captive supply and the spot market price of fed cattle has been identified in several studies . . ." GIPSA cited several studies in support of that proposition.

**Conclusion and Recommendation:** We believe that producer experience and economic data are clear that captive supplies have a negative impact on live cattle prices. Packer owned cattle, in our view, contribute substantially to that negative impact. Thus, the U.S. cattle industry should act decisively to prevent the continuation of such price-depressing practices.

In any event, the industry should act based on a standard of prudence. In other words, we need to prevent more harm from occurring. By the time the ongoing harm is definitively quantified, the damage to the U.S. cattle industry will likely become irreversible. The U.S. cattle industry should stand solidly in support of the Senate's packer ownership ban and work aggressively to ensure that this Amendment becomes law.

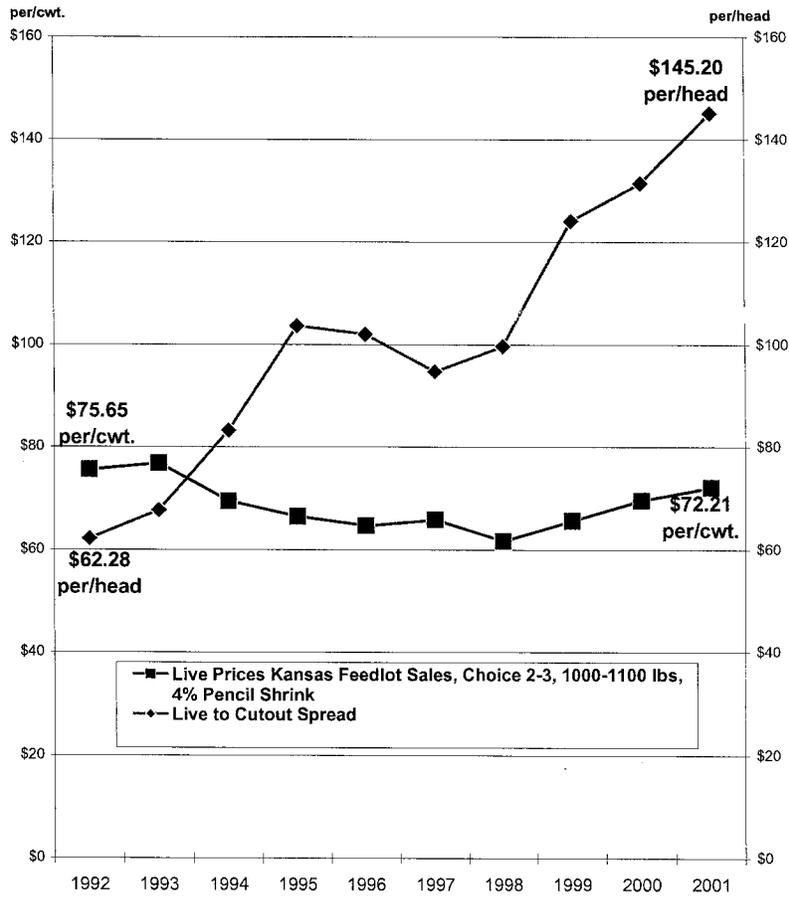
*R-CALF USA (United Stockgrowers of America) is a fast growing cattle-producer organization with members in 39 states and affiliate organizations that include local and state cattle associations and general farm organizations. All voting members are U.S. cattle producers. R-CALF USA represents U.S. cattle producers in trade and marketing issues.*

### Choice Retail Beef vs. Nebraska Direct



Source: USDA  
 Economic Research Service  
 Agriculture Marketing Service

### Packer Margins vs. Fed Cattle Price



Data Source:  
Livestock Marketing Information Center



**STATEMENT OF**

**MR. PAUL JACKSON**

**ON BEHALF OF  
THE NATIONAL FARMERS UNION**

**BEFORE THE**

**SENATE AGRICULTURE, NUTRITION AND  
FORESTRY COMMITTEE**

**JULY 16, 2002**

**Statement of Mr. Paul Jackson**  
**On behalf of the National Farmers Union**  
**Before the Senate Agriculture, Nutrition and Forestry Committee**  
**July, 16, 2002**

Mr. Chairman, members of the Senate Agriculture Committee, it is an honor to appear before you today to testify on behalf of the National Farmers Union and Oklahoma producers. I am Paul Jackson, a fourth generation agriculture producer from south central Oklahoma.

I farm and ranch with my father and brother and we each contribute equipment and labor to the operation. Our operation consists of 3,000 acres of mostly rented land, over 200 cow-calf pairs and, on average, about 1,800 stockers per year. In addition to our own calves, stockers are purchased from local auction barns in eastern Oklahoma. The remainder of the farm is in wheat, rye and alfalfa production.

At the outset, let me commend you, Chairman Harkin and members of the committee, for your efforts in developing comprehensive farm policy, the Farm Security and Rural Investment Act of 2002, that provides a better economic safety net for producers and addresses numerous other needs of farmers, ranchers and rural communities. We are independent and would prefer no government support, unfortunately we can't live without it. Without the help of the government in recent years, it would have been impossible to survive. I would also like to thank you for including mandatory country-of-origin labeling in this legislation. This was a big win for U.S. cattle producers.

While the recently enacted farm bill will help relieve symptoms of the economic distress in the countryside, the farm law alone cannot stop the hemorrhaging that is occurring in Oklahoma and across the nation. A key component in restoring the economic health and vitality of independent producers and rural communities is making structural changes in the agricultural sector that halt the negative effects of vertical and horizontal integration and revive competition and transparency in the marketplace.

America's livestock producers are living through - and we hope to survive - some tough times. The last time my father's tax return showed a profit was in 1989 which was near \$11,000 — well below the national poverty level. Last month, my brother started to work off the farm joining my wife, sister-in-law and myself in the endeavor to keep the farm afloat. Our operation is typical in that I have a full-time farm operation while needing also to maintain a full-time off-farm job to support my family. I do not take any living expenses from our agricultural proceeds. As I struggle to make it work, imagine other producers, like my father, who try to make their livelihood from farm proceeds alone.

The 2002 cattle price crash essentially resulted in my working an entire year for nothing and entering further into debt. It took me 25 years to pay-off a 45 acre tract of farming land. In one year the market wiped out the equivalent of what I had paid during that 25-

year period. This becomes very frustrating when at the same time feedlots and packers make record profits year after year at our expense.

The spring market slide has been linked to an array of issues, including 1) the tragedy of September 11; 2) the false report of a Foot and Mouth Disease case in Kansas; 3) the British woman in Florida diagnosed with Creutzfeld-Jakob Disease; 4) McDonald's interest in purchasing foreign beef for their restaurant chain; 5) and the influx of wheat-pasture cattle to market during this period of time. While these events may have contributed to market downward fluctuations, the market slide really began in earnest on February 19, 2002.

Our operation received active bids from buyers on the farm through Monday, February 18, 2002, with bidders promising in excess of \$0.84 per pound for approximately 625-pound weight heifer cattle. The market was closed on that Monday for President's Day. The following day the market opened down and proceeded to plunge in the days and weeks following. Little or no interest was given in purchasing cattle unless we effectively gave them away. When inquiring about the lack of interest compared to that demonstrated by the cattle bidders in the previous week, one bidder replied that buyers were staying out of the market for a few weeks because of the packer ban amendment pending in the House-Senate Farm Bill Conference Committee. The Senate had passed their version of the farm bill containing the packer ban language only a week earlier on February 13th.

We continued to hold our cattle that cost us more money each day and week hoping for a price recovery. It wasn't long before the price disparity from the February date had grown to \$10 per hundredweight, a decline of \$70 on each head. From February through April each animal's weight increased another 100 pounds. At the February 18 price we would have received \$525 per head. On April 3, 2002 at \$0.74 per pound for the larger cattle, we received only slightly more at \$534. This price is seven weeks later after investing thousands of dollars of feed into the cattle and foregoing wheat pastures that could have been baled for use as forage or harvested.

I ended the year as one of the lucky ones in that I cleared my note borrowed for the purchase of the stocker cattle, however I lost all of the other input costs related to my cattle operation. I am now in the hole by \$50,000. My first purchase cost of the cattle was \$406 per head average. The cattle sale average was \$480 per head. After deducting the cattle cost, interest, additional feed costs, medicine and associated veterinary supplies, the end result was \$30 per head left on the table – a far cry from the \$100 average annual projection of return. While the packers' profit margins have been enhanced by \$70 per head from the stocker producers' pocketbooks, cow-calf producers will realize lower prices and the brunt of the spring market crash next fall. Another great packer train robbery has occurred without a single shot being fired.

When I spoke with my local banker whose bank serves eight south central Oklahoma counties and lends \$15 million to \$20 million in ag loans annually, he said it was typical this year for producers to barely recover their first purchase cost of the cattle. This means

they lost their investment of time, interest, feed, veterinary supplies and other costs associated with the stockers. As a result there is little or no operating debt service capacity for stocker producers in Oklahoma. Some were not able to even recover the cost of their initial investment in the cattle.

In prior years we purchased options for price protection so at the very least we would not lose money. This year it was impossible to purchase that price protection because the cost of the option would have been equal to any marginal price protection provided.

Our family's experience is not unique. It has happened to Farmers Union, Farm Bureau and Cattlemen members whom I have spoken to in my state— Democrats, Republicans and Independents alike. There was a slaughter in Oklahoma this spring but it did not involve cattle. It involved the equity of producers. I have heard estimates that between 25 percent to 50 percent of our state's stocker producers are not able to pay back their cattle loans and service their operating debt.

I cannot provide hard data that there was a concerted effort by packers to drive cattle prices down in order to eliminate the packer ban provision from the farm bill, but the circumstances strongly suggest that this was more than an isolated market event. In fact, I believe it is evidence of the need for the very legislation the packers were trying to thwart. I find it ironic that the packers accomplished their goal to eliminate the packer ban provision – while jeering the ultimate insult to producers who received lower prices - because of their ability to manipulate and control the market. Packers doubly triumphed. They defeated the packer ban provision disadvantaging producers and consumers, and then scored gains on their ledger sheets by taking advantage of the lower cattle purchases costs without corresponding a reduction in retail prices.

## **POLICY RECOMMENDATIONS**

### **Ban on Packer Ownership of Livestock and Captive Supplies**

One of the first outcomes of today's hearing must be the passage of the ban on packer ownership of livestock. Distrust of the packer industry by cattlemen is analogous to the distrust that many citizens are feeling towards corporate America's accounting abuses. This legislation should be the top priority in helping to improve market performance, increase competition and enhance market access and opportunities for livestock producers.

The trend toward captive supplies and packer ownership has dramatically increased market power among the large agribusinesses. Captive supplies refer to livestock that are committed to a specific buyer two weeks or more before slaughter. A 2002 USDA Grain Inspections and Packers and Stockyards Administration (GIPSA) report estimated captive supplies to be 32.3 percent of the total slaughter of the four largest packers in 1999.

Packer ownership and captive supplies allow packers to stay out of markets at strategic times to influence the prices paid for open market cattle. To the extent packers prefer their company owned supplies over that of independent producers, those cattlemen had

far less access to markets. Major feeders, many directly related to packers, compete on the local level to purchase stocker cattle that they make available to other producers on contract. Two years ago in one northwest Oklahoma county over 30,000 stocker calves were under contract with one feeder as the owner of the cattle. This is not just a regional problem. Producers in the Upper Midwest are experiencing the same anti-competitive, market depression effects of packer ownership of livestock as hundreds of truckloads of packer-owned cattle are being shipped to their local processing plants competing with local supplies.

Producers will not benefit from more economic or academic studies concerning the effects of the packer ban. We need prompt action by Congress. In addition to enacting the ban on packer ownership of livestock, Congress should address the issue of captive supply. We recommend legislation that place restrictions on the percentage of captive supply a processor may have and require that firm bid pricing be established in forward contracts.

#### **Competition Title**

In addition to addressing packer ownership, we strongly recommend the passage of the Senate farm bill's original competition title in its entirety. The competition title developed and debated in this committee during the reauthorization of the farm bill encompassed provisions premised upon ensuring fairness, transparency, access, and enhanced competition in agricultural markets. While some provisions within the competition title, such as mandatory country-of-origin labeling and certain provisions concerning confidentiality clauses in contract production, were included in the Farm Security and Rural Investment Act 2002, we urge enactment of the following provisions:

- Prohibiting processors from engaging in unfair or deceptive acts in the marketing of any agricultural commodity;
- Prohibiting agribusinesses from retaliating against producers by terminating their contracts;
- Prohibiting secrecy clauses and arbitration clauses in producer contracts;
- Establishing within the U.S. Department of Agriculture an Office of Special Counsel for Competition to investigate, enforce and regulate competition matters.

The USDA Office of Special Counsel for Competition should aggressively investigate anti-competitive practices and market manipulation occurring in the agricultural sector and streamline and increase the effectiveness of USDA's enforcement of competition laws. The Special Counsel for Competition should have the authority and subpoena power to collect concentration-related information. For example, firms that account for a significant percentage of the market share at the regional level should be required to disclose information concerning mergers, strategic alliances and other joint venture arrangements.

The Office of Special Counsel should have the authority to seek outside counsel when conducting complex competition litigation. The Department of Justice already exercises this type of authority, such as when it retained David Bois to lead the Department of Justice's trial against Microsoft.

Some suggest conducting a study or forming a commission to review market concentration and to analyze the effects of proposed legislation before taking action. A key problem with academic reports or studies and commissions is the difficulty of obtaining specific data and information. Often the data that is available does not reveal the extent of the vertical integration occurring in the agriculture and retail sectors or the complex interactions among the top firms. One of the duties of the Office of Special Counsel for Competition would be to obtain such information and monitor the changes. Additional studies delay meaningful action. Every day as we wait the situation becomes worse in the countryside. The time for studying is past. It is time for action.

**Modernize GIPSA's Models and the Packers & Stockyards Act**

USDA's Grain Inspection, Packers and Stockyards Administration (GIPSA) has not adequately protected farmers from the unfair packer and processor conduct that has accompanied the structural changes occurring in the agricultural sector.

A 2002 GAO report, "Economic Models of Cattle Prices: How USDA Can Act to Improve Models to Explain Cattle Prices" reveals that USDA does not incorporate market concentration, marketing agreements or forward contracts in their livestock models. Moreover, the GAO review reports that USDA's entire model has not been revised in more than a decade, even though much of the data used to make estimations predates the rapid rise of concentration in the processing sector.

Congress should take action to require USDA to develop comprehensive and updated data and modeling frameworks in order to provide a complete representation of the cattle and beef industry. Accordingly, Congress should provide funding to assist USDA in making these changes.

A GAO report released in 2000 highlighted deficiencies within GIPSA and recommended actions for GIPSA to improve its investigations of competitive practices. Thereafter, Congress appropriated funding to enable GIPSA to reorganize. Yet, this has not translated into positive results in terms of the number of cases filed by GIPSA.

Congress should reform the Packers & Stockyards Act (P&S Act) to provide real protections to farmers, ranchers, and poultry growers. The legislation is over eighty years old and we do not market cattle in the same way as we did in the 1920's. The P&S Act worked. It led to divestiture within some highly concentrated markets, particularly in the auctions and stockyards. Stockyards are not allowed to own or control buying stations, packing plants, or livestock feeding operations. The basis of the P&S Act was that such ownership or control would create conflicts of interest, access problems for other producers, and opportunities for market manipulation which distort the market. In today's livestock sector, packers are similarly situated to the stockyards and auctions at the time of the enactment of the P&S Act in terms of their control over the market. The same rules should apply to them within today's market structure.

**PUBLIC POLICY CAN REVERSE MARKET CONCENTRATION**

The growing levels of concentration in agricultural markets are dramatically changing the ownership and control of the food system. Producers' abilities to make decisions concerning their farm and ranch operations are in jeopardy as a handful of firms exercise more and more control over decision-making throughout the food system. In 1999, the National Farmers Union commissioned a study authored by Drs. William Heffernan and Mary Henderickson entitled, "Consolidation in the Food and Agricultural System." The study identified that in the meat processing industry alone, the top four processing firms for beef, pork, and chicken control from 55 to 87 percent of the U.S. market.

In February 2002, Heffernan and Hendrickson updated the concentration ratio numbers from the 1999 report. The results revealed that concentration continued to increase in the major agricultural processing industries, except in ethanol production, in which levels of concentration actually decreased (1999: 67%, 2002: 49%). The decrease in concentration levels in ethanol production was directly the result of public policy decisions to encourage investment of new farmer-owned ethanol facilities around the country. Today, farmer-owned ethanol plants are the largest producer of ethanol in the country. The industrialization of agriculture is not the inevitable course for our food system as some would have us believe. Public policy has made a difference and can continue to make a difference.

**CONCLUSION**

Nearly one-third of the country's available feed-calf supplies can be found in the states of Oklahoma, Nebraska, Colorado and Kansas. The combined effects of low prices and the lack of competition are intensified by the severe drought pervading the countryside. I once heard a minister say that as long as there was life there is hope. The hope is fading and so is the lifeblood of the family cattleman. My grandfather used to say that as long as you held on to the ol' cow's tale, she would drag you through during the difficult times. Well, I am here to tell you that tail is a nub and we are slipping fast.

Policies, such as the packer ban on livestock, provisions in the competition title and the modernization of the Packers & Stockyards Act, are critical to halt the rapidly increasing vertical and horizontal integration occurring in the livestock sector and allow producers to share in the market value. Livestock producers, better than anyone, know how to produce top quality cattle, but they require open, transparent and competitive markets to benefit from their production.

Let me leave the Committee with one thought. Why in a market economy such as ours would we believe that companies seek to increase their market power and then fail to use that power for their own selfish objectives?

Thank you Mr. Chairman for holding this hearing and for the opportunity to testify today. We look forward to working with Congress and the Administration to restore competition and transparency in the marketplace and improve enforcement in the livestock sector.



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**Testimony**

**of the**

**National Cattlemen's Beef Association**

**to the**

**Senate Agriculture, Nutrition and Forestry Committee**

**The Honorable Tom Harkin, Chairman**

**July 16, 2002**

**Proposed Ban on Packer Ownership  
and  
Enforcement of the Packers and Stockyards Act**

**Presented by**

**Eric Davis, NCBA President-Elect**

Producer-directed and consumer-focused, the National Cattlemen's Beef Association is the trade association of America's cattle farmers and ranchers, and the marketing organization for the largest segment of the nation's food and fiber industry.

**AMERICA'S CATTLE INDUSTRY**

*Denver*

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### Introduction

Chairman Harkin, Senator Lugar, and Members of the Senate Agriculture Committee. I am Eric Davis, the President-elect of the National Cattlemen's Beef Association. I am a rancher and cattle feeder from Bruneau, Idaho, in the southwestern corner of the state. I am pleased to be here today to discuss with you an issue of the highest importance to beef producers; producer profitability. The topic of the hearing is a discussion of the Johnson amendment and Packers and Stockyards enforcement authority, but we would not be here if producers were in the black instead of bleeding red ink all over their income statements and cattle feeding closeouts.

Now is a difficult time to be in the cattle business. We have sustained losses for quite some time and the equity position of producers is not good. Industry analysts have estimated that more than \$2.5 billion of equity has been drained from the cattle feeding sector since 1999. This week cattle are trading at \$50-60/head below break even and the end is not yet in sight. During times like these, we all want to know the cause. We all want to know the solution. From a supply and demand front we are faced with:

- Heavy slaughter weights and record beef supply
- Reduced exports of beef and beef variety meats to Japan due to BSE in Japan – down approximately 40 percent January during the first 4 months of 2002 compared to the same time last year.
- Reduced business travel and foodservice demand following September 11<sup>th</sup>
- Limited confidence in Long side of the futures market due to market shocks, FMD and BSE fears
- Record supplies of competing meats
- Russian poultry crisis resulting in US poultry exports to Russia declining 45 percent during the first 4 months of 2002 compared to the same time last year.

Producers understand this. However, many believe that more than fundamental market supply and demand has to be at work to cause the sustained losses currently reverberating through the livestock sector. We have heard, as have you, calls for the implementation of legislation that would ban packer ownership of cattle, ban captive supplies, increase the authority of the Packers and Stockyards Administration (PSA), move PSA to the Justice Department, and outlaw mergers and acquisitions. These calls for legislative and regulatory intervention are a response to the frustration that many producers feel due to persistently sustained losses.

I understand the frustration. I live it everyday. It has been a difficult time to be in the beef industry. It has also been an equally difficult time to be the leader of a national organization that must represent producers in financial distress who have different ideas about where the industry is going and how we are going to get there, but share an equal passion and commitment for an industry with a proud and strong heritage of independence.

This independence is reflected in self-help initiatives that the beef industry has taken for generations -- to improve our product, to improve our markets and to improve our operations. I submit for your review the Long-Range Plan that has been adopted by our members. Its very title demonstrates our commitment to the long-term success of our industry, not simply inflating this quarter's returns.

In 1923, producers began to voluntarily contribute what is commonly known as checkoff dollars to help promote beef and improve demand for our product. The collection of these dollars culminated in the passage of the Meat Promotion and Research Order in the 1985 Farm Bill. Though the program is currently in litigation, producers have for over 80 years demonstrated a willingness to contribute to a fund to collectively improve the future of their industry and their individual operations.

Even though our industry is steeped in tradition and self-reliance, we have demonstrated the ability to change over time and to support legislation that enables us to endure. For example, beef producers first proposed the reforms which led to the Taylor Grazing Act to protect our public ranges from mismanagement. Cattle producers supported passage of the Federal Meat Inspection Act in 1906 because it gave beef better acceptance in the marketplace. Passage of the Packers and Stockyards Act—a 6 year process that entailed passionate debate with producers on both sides of the issue—passed and has been the key statute that has protected our industry for over 80 years.

Recently, the National Cattlemen's Beef Association supported passage of Mandatory Price Reporting, itself a contentious issue for many years. Though implementation of this law had growing pains in the beginning, we are now seeing many fruitful benefits of the information it provides -- some of which will be further discussed below. In the 1990s, against the wishes of some in our industry, then NCA supported the implementation of HACCP, a science-based inspection system that is the first big change to our meat inspection laws since 1906. HACCP is largely responsible for a decline of foodborne illness of over 22% since its inception according to the Centers for Disease Control.

These examples demonstrate that the beef industry has been willing to adapt, to change and to consider both private and government action. Thoughtful deliberation and prudent consideration of the impact of any legislation, including possible unintended consequences, should be considered before such action becomes the law of the land. We, therefore, appreciate that you scheduled this hearing today to allow for open discussion on these important issues.

#### **Ban on Packer Ownership**

The beef industry has endured no greater debate and dissension in recent memory than on the issue of banning the ownership of cattle by packers. The battle lines have been drawn with producers on both sides of the issue. Cattle producers established NCBA's policy after thorough and deliberative debate. Farm Bill conferees engaged in debate on the issue. There are qualitative studies that demonstrate benefits of the legislation and qualitative studies that demonstrate costs of the legislation with a lot of rhetoric, emotion and fervor on both sides. Due to this difference of opinion, the NCBA and the National Pork Producers Council commissioned Sparks Companies to quantitatively evaluate the issue. This analysis suggests the cost of implementation and the required restructuring of both the pork and beef industries would cost as much as \$10 billion if the packer ban were implemented. The study concludes that a ban on packer ownership would increase costs, impose inefficiencies, reduce competitiveness, and reduce beef and pork demand.

Many observers and proponents of the packer ban have criticized the Sparks study. They disagree with the analysis, disagree with the methodology and disagree with the results. The study is often criticized simply because NCBA or NPPC funded the study. Mainly it is criticized

because it is inconsistent with the proponents' preconceived conclusion. For all the criticism though, it remains, to my knowledge, the only empirical evaluation of the proposed ban on packer ownership.

Regardless of your opinion of the Sparks study, one thing is clear -- a ban on packer ownership would cause a restructuring of the beef industry. In the long run, everything would adjust and all cattle would find a home and all feedyards would find a buyer. The question however is "When and at what price?" Economist John Maynard Keynes said "In the long-run we are all dead." There is some truth to that, but there is a lot of living that has to be done between now and then. It is true that in the long run the beef industry would come back to equilibrium after a packer ban – but it would be a smaller, higher cost industry with a smaller market share.

NCBA's policy is always subject to change. NCBA encourages additional and continued dialogue and further study of the proposed ban. If others can demonstrate that the ban will provide more benefits than costs, our members will consider the new information. They might likely even support the ban. Until then however, NCBA remains opposed.

#### **Packers and Stockyards Enforcement Authority**

Recently, there have been many comparisons to the concentration in 1920 to the concentration today. Admittedly, the Big Five packers slaughtered 82 percent of all cattle killed in 1920 and the top four packers slaughter 80% of all fed cattle today. This fact is often used as justification enough to further increase the authority of the Packers and Stockyards Administration and to further regulate the beef industry. However, passage of the Packers and Stockyards Act in 1921 was preceded by a Federal Trade Commission report which concluded that "The power of the Big Five Packers in the United States has been and is being unfairly and illegally used to: manipulate livestock markets... restrict interstate commerce and international supplies of foods... control prices on dressed meats and other foods... defraud both producers and food consumers... crush effective competition... secure special privileges from railroads, stockyards companies and municipalities... and profiteer."

The Packers and Stockyards Act has been the law of the land since 1920. The beef industry has seen many changes since the passage of the law. Interpreting a 1920's statute relative to 2002 business practices and terms of trade may no longer be appropriate. None of the packers in 1920 are in business today. Measures have been taken to seek the changes, modernization, and adjustments that would bring the statute into the 21<sup>st</sup> century. The Act has been periodically updated with the most recent modifications in the 1980s. However, we must recognize that we have 21<sup>st</sup> century customers, a 21<sup>st</sup> century global marketplace, 21<sup>st</sup> century competitors and an entirely different set of packers than were in business when the Act was approved. The steps taken should provide for modernization of the laws to ensure oversight of the marketplace and enforcement of laws, but done so in a manner that does not hinder our ability to market the beef products that consumers want to buy. Producers sell cattle, but cattle produce beef for today's consumer who is the source of every dollar producers receive.

Specific recommendations that NCBA makes include:

- Enactment of a "Dealer Trust" to protect unpaid sellers similar to the "Packer Statutory Trust" already in law.

- Modify Packers and Stockyards definition of “captive supply” to “cattle sold in any manner other than negotiated sale, cattle sold with more than seven-day pickup, or packer financed/owned or controlled cattle.
- Review implementation of the recommendations recently made by GAO, OIG and legislation. Are these steps sufficient at improving the ability of GIPSA to enforce the law?
- Review all sections of the statute to determine what is current and what needs to be updated, modernized and improved for today’s beef industry.

#### **NCBA Price-Discovery Think Tank Recommendations**

NCBA President Wythe Willey appointed several NCBA members to a Price Discovery Think Tank to develop an outline of solutions to the problems currently impacting beef producers. The beef industry is a multi-faceted industry facing multi-faceted problems and as such we must take a broad approach to solving these numerous issues. The Price Discovery Think Tank has developed a list of action steps that need to be taken to help improve the long term viability of beef producers and the beef industry. These recommendations are not silver bullets. There rarely are silver bullets. These recommendations probably will not satisfy those who wish to take more dramatic measures. We respectfully request that the Committee review these action steps and help us help improve the future of the beef industry. We need the support of policy makers to take a pragmatic approach to solving these numerous problems. We would like to enlist your help and support in helping improve the industry by taking these small, but important steps. It takes a lot of steps to run a marathon, but each step is as important as the one that preceded it and the one that will follow.

After a series of discussions, the Think Tank will report and recommend to NCBA members the following:

More market information promised under the 1999 mandatory price reporting legislation passed by Congress through the efforts of NCBA soon will be available to help producers with price discovery. NCBA will take specific requests to the Chicago Mercantile Exchange regarding the live cattle futures contract. Also, Cattle-Fax has been asked to develop boxed beef and other base price indices that producers can consider as alternatives to the negotiated cash price for cattle sold through grids, formulas, alliances and other alternative marketing arrangements.

The Agricultural Marketing Service and Economic Research Service will soon be launching new reports that will provide additional information and add market transparency that hasn’t been available before. Cattlemen will have a clearer picture of the total value of boxed beef going out the packers’ back door and what consumers are actually paying for it at the checkout stand.

#### **National Comprehensive Boxed Beef Cutout/All Fed Steer/Heifer Sales**

The Agricultural Marketing Service is planning to launch by late summer a National Comprehensive Boxed Beef Cutout/All Fed Steer/Heifer Sales report that will cover 60-65 percent of boxed beef. This report will cover virtually all of the fed steer and heifer beef sales activity of the major packers; it will not include smaller plants not regulated by mandatory price reporting, some frozen exported product, beef from dairy steers and heifers, older product

nearing the sell-by date, inter-company transfers, and boxes from cow and bull plants. The latter continues to be available through voluntary price reporting. The boxed beef report will list the total weekly cutout value also segmented by rib, chuck, round, loin, brisket, short plate and flank values.

The report also will include all fed steer and heifer boxed-beef sales reported by:

- Total loads
  - Prime
  - Choice
  - Select
  - ungraded
- Types of sales
  - Negotiated sales 0-21 days
  - Negotiated sales 21+days
  - Formula sales
  - Forward Contract Sales
  - Domestic Sales
  - Exports

The Think Tank understands industry concerns about an ever-declining volume in the cash market determining the value of cattle delivered on formulas and grids. We believe the comprehensive cutout value will provide an alternative pricing point that could serve as the basis for pricing formulas and grids, in addition to the Choice and Select cutout values and USDA's by-product values. We need to find an alternative to the cash price as the basis for determining the value for cattle sold on formulas and grids. Cattle-fax will be commissioned to evaluate this and other alternatives, and producers will be encouraged to evaluate which base price alternatives best suit their individual marketing programs.

#### Retail Price Report

This fall the Economic Research Service plans to launch an as-sold, weighted-average monthly retail price report that will capture actual supermarket store scanner data. The report will give cattlemen a more accurate picture of what beef products are actually selling through retail and the prices that retailers are charging for beef.

The report data will be taken from 25 geographically diverse grocery retailers and capture over 20 percent of U.S. supermarket sales. The goal is to capture the impact of promotional pricing and develop a volume-weighted price based on beef actually sold by grade and region. Initially the prices series will be at the national level only but is designed to accommodate expansion to the regional level. While USDA already publishes two retail price-per-pound series for beef (Choice and All-fresh beef), those figures are averages based on retail price surveys by the Bureau of Labor Statistics that are collected once a month, while the ERS report will track sales continuously. The new report will figure in promotional discounts from shopper loyalty cards and coupons and will take into account the volume of each cut sold at retail.

The industry has not had accurate, volume weighted retail price information. This new information from ERS will give us market insight that we've never had before. One of the results of this data may be that the actual producer-to-retail price spread is smaller than currently

reported. The present price data doesn't include the impact of volume on overall price. For instance, if hamburger is shelf-priced at \$2.80 per pound, but a consumer can "buy one and get one free," the actual cost is \$1.40 per pound.

The new report will allow price tracking and comparison by the cut on a regional and year-to-year basis. Southard says one of the factors that the new price series quickly shows is the effect of seasonality or promotions. Eventually, the system could track retail prices for imported meat by country of origin provided the items are identified. When the report launches, it will contain historical information dating from January of 2001. Meat prices will be listed for about 140 cuts and categories, the majority of them beef. One of the challenges in developing this report was a lack of standardization with price codes of meat cuts. ERS has had to analyze about 50,000 different price scanning codes to eliminate duplicates and create single product categories. In some cases, one cut may have had as many as 11 different codes or names.

The industry hasn't yet discovered a means to accurately reflect prices going into the restaurant trade, which accounts for 48 percent of sales. The Think Tank recognizes this as a future information need, but we need to make sure that we have accurate usable boxed beef and retail price information before we begin to address that issue.

#### A Fair Base Price

With fewer cattle being sold on the spot cash market, cattlemen have struggled with a means to determine a fair base price for those sold on grids or through other marketing arrangements. Cattlemen selling on the cash market have expressed their displeasure in being used as the "price discovery mechanism" for non-cash programs including formulas and grids. Likewise, cattlemen using alternative marketing programs have expressed their dissatisfaction with using a shrinking number of cattle in the cash market to set prices for alternative programs.

The Think Tank agrees that it is time to find an alternative to using the cash price as the base for formulas and grids and we are encouraging aggressive evaluation of a number of alternatives, including boxed beef and retail prices. The Think Tank is pursuing a transparent marketing tool that allows producers, regardless of what marketing system they use, to compare the advantages different systems offer for their cattle. The Think Tank asked Cattle-Fax to develop and evaluate alternative base price indices to be reviewed by the industry. With these new tools, producers will have a better idea of how cattle are trading under different marketing arrangements and can choose a program that best fits their cattle.

#### The Futures Market

Recent volatility in the futures markets has caused some cattlemen to question the validity of the live cattle futures contract as a risk management tool. The industry desperately needs a viable, predictable, market-sensitive risk management tool if we expect continued support from lenders and credit availability. One component of the Think Tank is the Futures Working Group, which works directly with the Chicago Mercantile Exchange (CME) on issues of concern to cattlemen. That group met with the CME June 18 in Chicago. The Think Tank heard a report and recommendations from that meeting and forwarded back recommendations to be discussed with the CME. Those include:

- The industry will supply more information to the Chicago Mercantile Exchange on heifer delivery, which cattlemen have sought and the CME has not accepted.
- Think Tank members believe they can help relieve bottlenecks at delivery points on futures contracts. The random nature of contract delivery has led to the perception that there is a shortage of USDA graders to evaluate the cattle. On any given day, one delivery point may be swamped with deliveries while another is underutilized. Think Tank members propose specifying days and locations of delivery to alleviate bottlenecks that result in some cattle being put back on feed.
- Cattlemen want to further discuss the concept of serial contracts to allow delivery every month. The Think Tank also believes that short-term changes are needed for the present contract, including adjusting acceptable weights so to be consistent with current production practices and reducing position limits for speculators. In the near-term, work must begin on a new generation contract, possibly a futures contract for the Choice boxed-beef cutout or the soon-to-be released comprehensive boxed-beef cutout.
- The Working Group will request that the CME develop a public position on how trading will be conducted in the event of a foreign animal disease outbreak.

#### Captive Supply

Members acknowledged that captive supply has become a source of frustration in some parts of the industry, but there is little willingness in the industry to accept USDA's definition of captive supply. NCBA policy defines captive supply as cattle sold for delivery with more than seven day pickup. This policy is at odds with the government's definition, which sets the time limit at 14 days.

Given the different opinions within the industry, the Think Tank will aggressively work toward developing a more acceptable definition. The Grain Inspection, Packers & Stockyards Administration and Agricultural Marketing Service release different figures as to what percentage of sales are comprised of different types of transactions. P&S uses a pure definition for captive supplies while AMS reports cattle sold by different types of transactions — negotiated, formula marketing arrangement and forward contract. The P&S definition states that all cattle sold by formula marketing arrangements or on a non-negotiated basis are not necessarily captive supplies. Most producers disagree and prefer to think that all non-cash transactions are captive. NCBA will approach both agencies to see if either can change its definition and what it takes to do so.

#### Retail Segment

The Think Tank wants to strengthen its understanding and communications with the retail community. Increasingly, retail buying practices have impacted packers' ability to charge higher prices for beef and that ultimately impacts the prices that packers pay for cattle. As cattle prices have dropped, retailers have claimed a larger share of the consumer's dollar. While the new retail price reporting series will likely adjust the ranch-to-retail spread downward, it has reached record-large proportions. This is yet another factor that has created industry unrest. NCBA believes that it is important to bring this important partner in the marketing chain to the bargaining table.

**Conclusion**

The NCBA and our predecessor organizations have relied upon a market-based, market-driven, consumer focused approach to provide long-term opportunity for beef producers. By meeting customer needs, we can best create opportunity for ourselves. We see cattle producers as selling beef to a demanding customer.

We recognize that there are competing visions in the beef industry. The other vision sees beef producers as simply selling cattle to the next link in the chain. To be clear, the value for cattle is established by what the customer is willing to pay for the beef in that animal. With all the choices today's consumer has, we must strive to meet their needs and demands. All producer dollars come from the consumer. This other vision would also rely upon increased regulation, and hence increased cost, on an industry already beset by costly regulations.

The National Cattlemen's Beef Association believes that we must compete in a global environment and meet global customer needs. To do that we need to have the flexibility to adjust business plans and practices that help us meet global demand. We must continue to have a world class infrastructure that ensures safe, healthy and wholesome beef to consumers. We must have a business and regulatory climate that ensure commerce is fair, open, transparent and not overly burdensome. When action must be taken, it must be well-thought out, evaluated, and tailored to suit the problem in need of a solution.

To evaluate problems and identify solutions, one needs the best information available. For that reason, NCBA requested funding for a broad-based study of the meat protein complex. Our request called for preeminent business schools to conduct an industry study and evaluation of the meat complex to determine our competitiveness and to review business models that will ensure long-term success for beef producers. The House Agriculture Appropriations Subcommittee approved \$4.5 million for this study and the full House Appropriations Committee recently reported this bill out of committee. We urge you to support similar language and funding in the Senate so that this study can get underway. Hopefully, this evaluation will provide a scorecard on current initiatives and a roadmap for future efforts that will improve the opportunities for beef producers.

We believe the recommendations in our Think-Tank initiative will help us get the industry back on the right track. The Packers and Stockyards Act should be modernized to fit today's business practices. I ask for your help and support in helping us make these changes and we commit to working with you so that we can find the right mix of private and legislative actions that will build consensus and steer a long-term course for the future of the beef industry.

*Sparks Companies, Inc.*

*Potential Impacts of the Proposed Ban on  
Packer Ownership and Feeding of  
Livestock*

*Executive Summary*

**Foreword**

Last December, Senator Johnson (D-SD) proposed an amendment (the "Johnson Amendment") to the farm bill that would amend the Packers and Stockyards Act (PSA). Subsequently, Senators Grassley (R-IA) and Harkin (D-IA) offered a second-degree amendment to further define the wording of the initial amendment. At this time, the revised amendment is included in S. 1731, passed February 13, 2002. The House farm bill contains no such amendment.

The amendment would make it unlawful for meatpackers to own, feed or control livestock for more than 14 days prior to slaughter. Cooperatives, or entities owned by them, would be exempt if a majority of the ownership interest in the cooperative is held by active cooperative members who own, feed or control livestock and provide them to the cooperative for slaughter. The amendment also would exempt packers who slaughter less than two percent of annual slaughter of each type of livestock.

**Study Methodology**

This is a study of the potential impacts of the Johnson Amendment. It examines how the various segments of the pork and cattle industries would be affected by a ban on packer ownership, and the short and long-term impacts. The study is based on extensive review of economic statistics, studies and reports and interviews across the major industry sectors by experts with first-hand knowledge of the beef and pork industries.

The study was commissioned by the National Cattlemen's Beef Association (NCBA) and the National Pork Producers Council (NPPC) to be an objective evaluation of both the source of the current structural change in the red meat industry, and likely impacts of the Amendment.

Sparks Companies, Inc.

**Sparks Companies, Inc., is the world leader in broad-based agricultural and commodity market research, analysis and consulting. Founded in 1977, the company now serves more than 750 firms and institutions worldwide from our headquarters in Memphis, Tennessee, our Washington, D.C. office and a far-reaching network of offices overseas.**

***Potential Impacts of the Proposed Ban on  
Packer Ownership and Feeding of  
Livestock***

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# *Potential Impacts of the Proposed Ban on Packer Ownership and Feeding of Livestock*

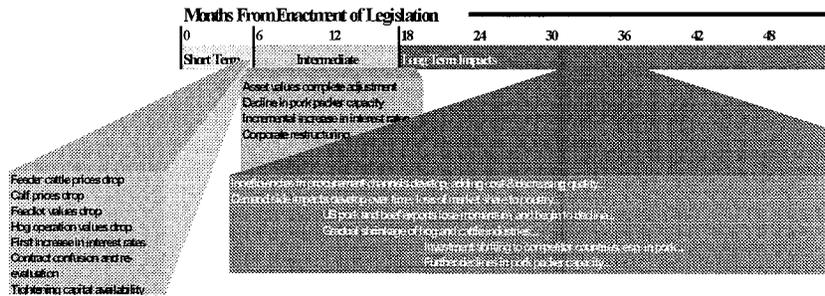
## Executive Summary

### Study Findings

The Johnson Amendment likely would result in immediate and long-term negative impacts for all sectors of the US pork and beef industries, from independent producers to packers. No segment can expect to benefit, and each would likely face significant losses.

- The Amendment assumes that packers use livestock ownership and marketing arrangements to exert market power at the expense of independent producers, and would outlaw many common management tools, primarily packer ownership of livestock.
- This intervention would strike at the heart of recent industry advances, reducing efficiency and raising costs at all levels of production and processing. And, it could undercut recent increases in consumer demand and export sales.
- The costs of such interventions would be felt immediately, and some costs would continue indefinitely (See Diagram).

**Time Line of Packer Feeding and Ownership Ban Impacts**



The contrast between states with growing herds and those where swine herd numbers declined is stark. All of the principal declining states were characterized by restricted packer ownership,

with no packer ownership allowed in eight of the ten. In nine of the ten rapid-growth states, there was a significant component of packer ownership of hogs while in the remaining state a strong contracting linkage was permitted between producers and packers.

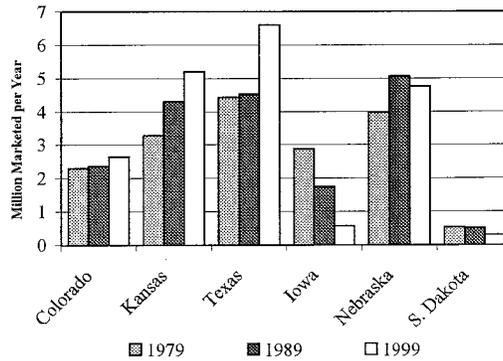
#### 10-Year Trend in US Swine Breeding Herd and Relationship to Packer Ownership of Hogs

Top 10 Breeding Herd Growth States ('000 head Dec 1)						
Rank	State	1992	2001	Increase		Packer Ownership
				%	head	
1	UT	6	70	1067%	64	YES
2	OK	35	340	871%	305	YES
3	WY	5	21	320%	16	YES
4	CO	55	175	218%	120	YES
5	NC	500	1000	100%	500	YES
6	TX	70	100	43%	30	YES
7	PA	105	130	24%	25	YES
8	MS	25	28	12%	3	NO
9	KS	160	170	6%	10	YES
10	MO	375	380	1%	5	YES
Total/Avg.		1336	2414	81%	1078	

Top 10 Breeding Herd Decline States ('000 head Dec 1)						
Rank	State	1992	2001	Decline		Packer Ownership
				%	head	
1	GA	155	50	-68%	-105	NO
2	TN	85	30	-65%	-55	NO
3	WI	170	65	-62%	-105	NO
4	KY	120	50	-58%	-70	NO
5	SD	235	145	-38%	-90	NO
6	IN	550	340	-38%	-210	NO
7	MI	175	110	-37%	-65	NO
8	NE	580	370	-36%	-210	NO
9	IL	700	450	-36%	-250	SMALL
10	IA	1700	1130	-34%	-570	SMALL
Total/Avg.		4470	2740	-39%	-1730	
US		7109	6209	-13%	-900	23%

Similarly, in states that have constrained investment in cattle feeding marketings have declined, while others have attracted substantial new investment (See Chart).

Cattle Marketings, Selected States, 1979-99



#### Amendment Costs

The study examined potential impacts of Amendment costs at all levels of the industry, and estimated cost impacts at each level. Cost impacts would differ widely, both in their timing and in their impacts. Impacts are measured at the producer level for both cattle and hogs.

- **Initial divestiture impacts would be severe but temporary, and would affect packer-owners and other livestock owners, as well.**
  - For hogs, the midpoint estimate of this one-time cost is \$1.2 billion, but could reach \$1.8 billion or be as low as \$0.6 billion depending on market conditions.
  - For feeder cattle and calves, the midpoint of this estimate is \$2.4 billion, but could reach \$2.5 billion or be as low as \$2.3 billion.
- **Increased capital costs across the industry as lenders increase their risk premium.**
  - For hogs, the midpoint estimate of this impact is \$83.5 million, but could be as high as \$133 million or as low as \$34 million.
  - For cattle, the midpoint estimate is \$314 million, but could be as high as \$523 million or as low as \$105 million.
- **Reductions of packers' operating efficiency and increased risk.**
  - For hogs, the midpoint of the estimate of this impact is \$1.4 billion, but could be as high as \$2.16 billion or as low as \$0.55 billion.
  - For cattle, the midpoint of this estimate is \$90 million, but could reach \$130 million or be as low as \$51 million.
- **Reduced domestic demand for meats.**

- For hogs, the midpoint of this estimate is \$357 million, but could be as high as \$595 million or as low as \$119 million.
- For cattle, the midpoint of this estimate is \$213 million, but could be as high as \$267 million or as low as \$160 million.
- **Reduced export demand for meats.**
  - For hogs, the midpoint of this estimate is \$469 million, but could be as high as \$750 million or as low as \$188 million.
  - For cattle, the midpoint of this estimate is \$53 million but could be as high as \$66 million, or as low as \$40 million.
- **Transfer and relocation of significant amounts of pork production and ownership to Canada and Mexico.** The midpoint of this estimate is \$1.1 billion, but could be as high as \$2 billion or as low as \$0.1 billion.

Impacts expected across the sector likely would be large, would begin immediately and could severely damage the sector's competitive position in US and overseas markets. Midpoint estimates of losses for hogs across categories, and including both temporary and continuing costs are \$4.5 billion, but could reach \$7.4 billion or be as low as \$1.6 billion. The midpoint estimate of losses for cattle across categories could be somewhat smaller, \$3.1 billion but could be as high as \$3.5 billion or as low as \$2.7 billion.

#### **Impacts on States**

Impacts of the Amendment would vary widely by states, depending on the size of the production and packing industries located in each. (See tables). The estimates represent losses for hog producers, and are allocated on the basis of each state's breeding herd. The allocation does not reflect situations where some adjustment to packer feeding restrictions have already occurred, but is indicative of relative impacts of the Amendment.

The losses include both losses from temporary, one-time events and those evolving from declines in competitiveness and efficiency. The estimates represent the midpoint of the ranges estimated for each state. For example, for Iowa, the mid-point estimates of all types of losses would amount to \$0.8 billion, could be significantly lower or as high as \$1.3 billion.

**Impacts of Johnson Amendment of Hog Producers by Type of Loss, by State**

State:	Capacity	Credit	Equity	Efficiency	Risk	Demand	Exports	Relocation
	million \$							
IA	181	15	216	15	48	64	84	189
NC	161	13	192	14	42	57	75	168
MN	91	8	108	8	24	32	42	95
IL	70	6	84	6	19	25	33	74
NE	60	5	72	5	16	21	28	63
MO	60	5	72	5	16	21	28	63
IN	50	4	60	4	13	18	23	53
CO	30	3	36	3	8	11	14	32
KS	30	3	36	3	8	11	14	32

Impacts are midpoint of range estimates, allocated by Dec 1, 2001 breeding herd share.

The losses for cattle also include both losses from temporary, one-time events as well as those evolving from declines in competitiveness and efficiency. The estimates represent the midpoint of the ranges estimated for each state. For example, for Texas, the mid-point estimates of all types of losses would amount to \$0.5 billion, and could be significantly lower or as high as \$0.6 billion. The estimates do not reflect situations where some adjustment to packer feeding restrictions have already occurred, but are indicative of relative impacts of the Amendment.

**Impacts of losses for Cattle Producers by Type of Loss, by State**

State	Demand for	Cost of	Loss of	Plant	Risk Cost	Loss of	Loss of Export
	Feeder	Credit	Feedlot Asset	Efficiency		Domestic	
	Animals		Value	Loss		Demand	Demand
	---- Estimated Impact By State (in Million \$) ----						
TX	244.1	59.2	167.8	9.2	7.8	40.2	10.0
KS	71.2	38.0	144.0	5.9	5.0	25.8	6.4
NE	88.1	36.6	130.3	5.7	4.8	24.9	6.2
CO	39.0	22.8	87.8	3.6	3.0	15.5	3.8
OK	91.5	14.9	29.5	2.3	2.0	10.1	2.5
SD	96.6	11.8	13.0	1.8	1.6	8.0	2.0
CA	66.1	10.7	20.9	1.7	1.4	7.3	1.8
IA	50.9	10.0	24.5	1.6	1.3	6.8	1.7
MO	98.3	9.1	0.0	1.4	1.2	6.2	1.5
ID	33.9	8.6	25.2	1.3	1.1	5.9	1.5
MT	76.3	7.1	0.0	1.1	0.9	4.8	1.2
WA	17.0	6.4	22.3	1.0	0.9	4.4	1.1
KY	50.9	4.7	0.0	0.7	0.6	3.2	0.8
AZ	10.7	4.4	15.8	0.7	0.6	3.0	0.7
NM	25.4	3.8	6.5	0.6	0.5	2.6	0.6

**Impacts by Species**

The estimated range of impacts on the hog production sector varies widely, across the range of impact sources (See table). The loss of equity for farrow-to-finish operations reflects value of both facilities and hogs, on a per-sow basis.

### Potential Impacts of Amendment per Head of Hogs

One time Impact on Hog Production Sector 1/	Low	Midrange	High
Loss of Farrow-Finish Equity Value	100.00	200.00	300.00
<i>\$ per sow</i>			
Recurring Impacts on Hog Production Sector 2/	<i>\$ per barrow or gilt</i>		
Reduction in US Packing Plant Capacity	3.36	10.64	17.91
Cost of Credit	0.36	0.89	1.41
Plant Efficiency Loss	0.36	0.91	1.45
Risk Cost	2.10	2.80	3.50
Damage to Domestic Pork Demand	1.26	3.78	6.29
Damage to Pork Export Demand	1.99	4.96	7.93
Relocation of Investment	1.06	11.10	21.14

1/ A one time impact allocated across 6 million breeding inventory.

2/ Ongoing Impacts allocated across annual barrow and gilt slaughter.

Individual impacts may not be additive because of interactions.

The estimated range of impacts per head across the cattle sector varies widely, across the range of impact sources (See table). The loss of equity for feedlot asset values reflects value of both facilities and hogs, on a per-head basis.

### Potential Impacts of Amendment per Head of Cattle

Cattle Feeding Segment (\$/hd fed in one year) 1/	Low	Midrange	High
Loss of Feedlot Asset Value	\$ 21.05	\$ 25.26	\$ 29.47
Calf Production Segment (\$/hd. destined for feedyard) 2/			
Demand Impact on Feeder Animals 3/	\$ 44.37	\$ 44.37	\$ 44.37
Cost of Credit	\$ 2.74	\$ 8.22	\$ 13.69
Plant Efficiency Loss	\$ 0.52	\$ 1.28	\$ 2.04
Risk Cost	\$ 0.81	\$ 1.09	\$ 1.36
Damage to Domestic Beef Demand	\$ 4.18	\$ 5.59	\$ 6.99
Damage to Export Beef Demand	\$ 1.05	\$ 1.39	\$ 1.73

1/ A one-time impact spread across 28.5 million head.

2/ In the long-run all of these items flow back to the bottom of the marketing chain and that is what is reflected here.

Short-term, the feeding sector may bear some of these costs.

These figures are estimates only and are not considered to be additive.

3/ Transitory loss, not expected to persist more than a year or two.

### Under the Johnson Amendment

- US production efficiencies decrease, resulting in declines in the industry, increasing opportunities for competing products and competing international producers who could become more efficient and better marketers than US producers. Weaker domestic and export demand could accelerate these declines.

- The US poultry industry, which has grown more than 600% since 1960 could face less competition for US markets.
- Declining margins for both packers and feeders could stimulate consolidation as higher-cost operations, most often the smallest, are forced to close.
- Investment in superior products and retail brands would be constrained and the capacity of processors to satisfy demands of rapidly consolidating retailers for greater uniformity and higher quality would decline, both in the United States and overseas.
- Very substantial immediate losses for livestock producers and narrower margins for the meatpacking industry would reduce tax revenues and increase federal and state budget pressures.

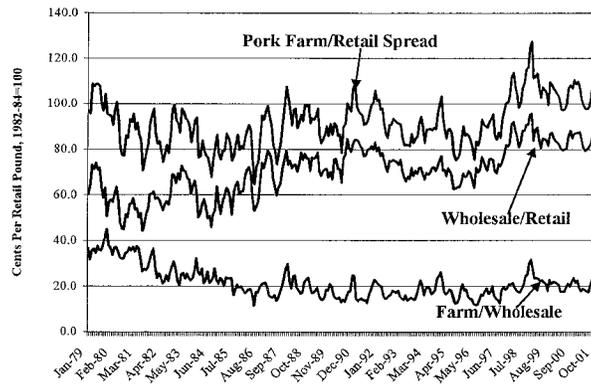
#### **Focus of the Debate**

Proponents of the Amendment appear to misunderstand the nature of the competitive forces driving change across the red meat and poultry industries today. The study concludes that primary competitive pressures among products are at the consumer level, driven by basic changes in society and domestic and international demands for quality, convenience, and services as lifestyles evolve (See Charts). The vast bulk of the change in prices and values at farm, wholesale and retail levels reflect costs of services while the farm-wholesale spread has been stable or declining for most of the past two decades as efficiency has grown. New costs packers are required to pay in recent years include:

- Inspection fees and new steam vacuum procedures for carcasses, along with an acid bath that also adds to costs;
- Trimming costs, with most beef now sold as closer trim (1/4 inch or less) compared to commodity trim (3/4 inch or more), thus increasing costs. And, more product now is boneless, especially beef;
- New, more expensive safety rules such as HACCP, waste water treatment and others;
- Higher labor costs in response to much tighter supplies of labor.

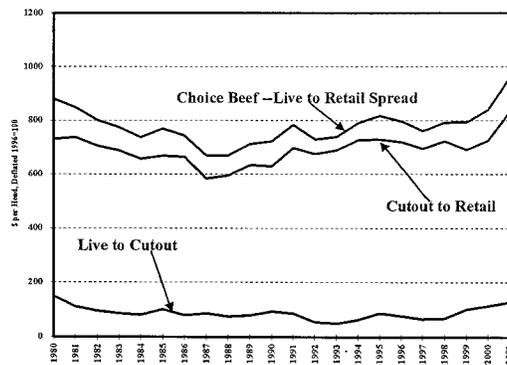
In spite of higher costs, the farm to wholesale spreads shown below are generally lower than they were in the 1980s in inflation-adjusted terms, and reflect steady increases in efficiency across the sector. Nevertheless, the legislation proposes to regulate the farm and processor levels while the major widening of the spreads has been at the wholesale-retail levels.

**Pork Price Spreads, 1979-2001**



Source: ERS, USDA

**Beef Price Spreads, 1980-2001**



The poultry industry pioneered the strategy of providing additional services to compete with other meats as an avenue to market growth in the 1950s, and the red meat sectors followed that success more recently. A significant negative impact of the Amendment is that it would

constrain beef and pork industry efforts to provide the consumer-friendly products to compete with poultry at the consumer level.

The proposed Amendment would intervene at the processing and livestock production levels where product competition is mainly reflected, not where it originates. It would impose unwarranted costs where they would benefit no one, without strengthening demand, efficiency, technology, or competition. Over the longer-term, the Amendment would be unlikely to benefit any sector in the domestic beef or pork industries, and especially not livestock producers who expect wider margins and greater independence to result from this proposed legislation. The end results likely would be lower producer prices, higher costs, smaller markets and diminished returns for the foreseeable future. The study evaluates both the source of the current structural changes in the red meats industry, and the likely impacts of the Amendment.

### **Transition**

Proponents of the Amendment argue that the transition periods it includes would permit an orderly transfer of ownership of packer-owned livestock and facilities. The study concludes, based on extensive interviews across the industry that such a transition is quite unlikely. Instead, the proposal would have major short-term and longer-term impacts, including:

- **Divestiture of packer-owned livestock, and packer owned livestock feeding facilities.** While this would take place over transition periods for beef and pork, the impacts would be severe, immediate and persistent. They would reduce the value of livestock, livestock feeding facilities, and breeding facilities throughout the United States. By restricting packers' application of a number of strategic management tools, the Amendment would be expected to increase operating costs, reduce output and reduce returns to both packers and livestock producers.
- **Curtailement of new marketing contracts by packers.** Given the intensive factual inquiries required to assess "material participation" as required by the amendment make it impossible for packers to confidently assess the legal risks presented by existing arrangements under the Amendment. It is likely that packers who have committed to purchase livestock under long-term marketing agreements would refrain from offering new contracts to producers until the legislation is clarified or enforcement of the legislation is made clear by the USDA.

Surveys by Iowa State University indicated that 22,748 hog producers sold more than 1,000 hogs in 2000. About one-half of the smaller producers (<5,000 hogs sold) used marketing contracts. Thus, it is clear that substantial restrictions on such contracts would have negative impacts on many smaller operations.

- **Curtailement of financing by lenders.** For similar reasons, it also is likely that lenders, which finance livestock producers, would desire time and clarification of the legislation before advancing new funds for the expansion of facilities or herds. Frequently, such expansions are based, at least in part, on the terms of long-term marketing agreements by which producers secure a buyer for their production, obtain premium prices and limit

market risk. Should such arrangements become legally suspect, it is only logical to expect that lenders would not be willing to absorb this additional risk.

- **Revision of existing marketing contracts.** Should packers determine that the legislation impairs their ability to enter into long-term marketing arrangements, we would anticipate they will attempt to identify other tools to achieve the goals, which such contracts have provided them. This may require packers to attempt to renegotiate existing contracts inasmuch as the legislation does not exempt existing contracts from its scope.
- **Corporate restructurings.** Packers could also attempt to meet the terms of the Amendment via various restructurings or liquidations of selected assets. At least one packer has publicly suggested that it would cease operations at one of its plants should the Amendment be enacted. The Amendment would appear to require packers who own livestock to divest themselves of such livestock. The manner of such divestitures would likely be carefully considered by all affected packers, and likely would diminish interest in investment in the industry.
- **Litigation.** Should the Amendment be enacted, there likely would be litigation relating to this legislation brought by packers and/or producers. Challenges to the required divestiture of livestock by those packers that currently own livestock and the exemption for poultry contained in the Amendment also could be brought and would serve to reduce willingness to invest in the industry.

#### **Intermediate Term Impacts**

The intermediate impacts of the Amendment likely would be extensive and entirely negative. They would likely include:

- **A higher-cost, less efficient meat packing industry** in the future with smaller capacity to produce and process cattle and hogs. Costs would be increased by increased costs of capital, reduced plant utilization, higher price volatility and risk and reduced revenues from livestock production. The higher costs would reduce margins and lead to reduced bids for livestock at the farm level. Lower returns at each level would reduce state and federal tax returns for the sector.
- **Reduced packer-processor investment** at both ends of the value chain, in genetics and livestock management and in branded products and market development. This likely would reduce competitiveness of red meat products in competition for US consumers' dollar, and in export markets. It likely also would mean a reversal of current growing market shares in both markets.
- **Higher-cost, less efficient feeding and breeding industries** in response to higher capital costs for livestock feeders and breeders, reducing margins for both types of investment.
- **A smaller meat packing industry** as lower margins cause less-efficient packers to cease operations and reduce industry capacity. The higher costs would make US packers less

efficient in competing with poultry at the consumer level and less efficient in competing with the Danes, Canadians and Brazilians for foreign markets.

- **Smaller breeding and feeding industries** as higher capital costs and weaker returns lead to reduced investment in livestock feeding and breeding, and reduce industry production capacity. The smaller industry would be more dependent on both imported livestock for slaughter and imported meats and meat products.
- **Increased vulnerability for producers in isolated production areas** as packers access to tools to manage supply flows and plant utilization are constrained.
- **Continuing advantage for poultry in the competition** for domestic and international consumers' dollars as investment in quality by the red meat sectors decline. The poultry industry would be in a position to continue to invest in quality and market development efforts while investment and development by red meat producers/processors would decline.

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Testimony

of

John S. Butler, President and CEO  
Ranchers Renaissance Cooperative, Inc.

to the

Senate Agriculture, Nutrition and Forestry Committee

The Honorable Tom Harkin, Chairman

July 16, 2002

Proposed Ban on Packer Ownership  
and  
Enforcement of the Packers and Stockyards Act

### **Introduction**

Chairman Harkin, Senator Lugar, and members of the Senate Agriculture Committee, I am John Butler, President and CEO of Ranchers Renaissance. I represent beef producers who are involved in every segment of beef production, ranging from ranching to marketing branded beef. I have been involved in the cattle and/or beef industry my entire life, and am pleased to be given the opportunity to discuss with you an issue that is a top priority for us all.

You are holding this hearing to consider government intervention and/or regulation to resolve the beef industry's marketing challenges. I appreciate your desire to help. However, there are a number of issues—including fundamental supply and demand challenges—that have created this situation. Whether or not packers are involved in the ownership of cattle will not change these significant factors.

I am here today to briefly explain to you an initiative that was created by producers six years ago to address many of the fundamental problems associated with the commodity beef marketing system. Ranchers Renaissance is an example of how producers and packers can work together to regain precious market share and most importantly sustain long-term profitability. Removing any participant of this system dramatically and negatively affects those remaining.

### **Ranchers Renaissance Cooperative**

In 1997, a meeting initiated by a group of beef industry leaders was held to address key marketing problems facing the ranching community. They agreed that it would be necessary to have a common focus to affectively address concerns related to the flawed commodity pricing and marketing system. They agreed the focus should be driven by the consumer, and that consumers would embrace a branded beef product that delivered on a promise. Such a commitment would require consistent processes to meet the quality and consistency elements essential to a successful brand. It was also agreed that this consistent process would require a steady supply of predictable cattle to fill the products of a branded line. In addition, being fairly rewarded for producing value based on consumer demand was a priority. From this initial meeting, it was obvious that developing partnerships that cross over from one segment to the other in the beef-producing value chain would be the solution to pursue. The result of these discussions was Ranchers Renaissance. Ranchers Renaissance was conceived as a vertically integrated cattle marketing cooperative. Our mission is to be "A customer-focused, high-quality, integrated beef production system with profits derived from increased efficiency and consistent, value-added, finished products."

The Ranchers Renaissance membership consists of ranches, feed yards, and a packer/processor. Our cooperative was designed to accommodate ranches of varying sizes. Our ranch members own or manage 100 cows or more and are located in numerous states from Florida to Hawaii. Our feed yards are privately owned and range in size from 12,000 to 45,000 head capacity. We utilize different genetics based on environmental conditions and are able to use cattle from different regions with different calving seasons so that we can produce beef that will meet the agreed upon specifications 365 days a year. After five years of working with these producers, I can assure you that they have at least two things in common—one, tremendous independence, and two, a passionate commitment to our vision.

### **The Structure**

Essentially, we have created a systems approach to beef production. Rather than operating as individual segments within the system, the members of Ranchers Renaissance have aligned and

have agreed to a number of quality standards for the entire value chain that were developed to ensure the production of consistent beef that will meet or exceed consumer expectations. The system we have implemented is not rocket science. It is, however, a series of validated production and best management practices that result in a higher quality, more consistent product. You might say “So what? You have a system that has the ability to produce higher quality, more consistent cattle. How does this help cattlemen?” Good question.

The next step in our process was to merchandise our efforts to an end user and to develop economic drivers to reward producers for creating value in a product that the consumer demands. We have done so, and have now become a critical supplier to the brand “Cattlemen’s Collection” which is now being merchandised as the every-day beef product and represents the entire fresh meat case in more than 350 Kroger stores. In less than a year, the consumer has changed buying behavior in these markets and actually purchased more beef products. In addition, the consumer is gaining brand recognition as well as loyalty. We are now in the process of expanding this program into additional regions of the country.

It is important for you to appreciate that the ultimate value in our branded product is the result of synergy between segments (rancher, feed yard, and packer/processor). In other words, each of our members is responsible for a contribution to the promise we have made to the consumer. As an example, the ranchers add value by using the right genetics and best management practices to produce a healthy calf to be nominated to Ranchers Renaissance. The feed yard members add value by managing and feeding the cattle in a processes verified manner, and harvesting these animals to meet featuring needs of the end user. Our packer/processor member adds value by disassembling and fabricating the animals to ensure the timely delivery of product. In addition, their expertise in marketing and merchandising our beef to meet the brand criteria is a critical responsibility.

In total, we have twenty-four quality control points that build on the promise to our brand. Adhering to these specifications is not easy, nor is it cheap. We have added costs to our system, including better genetics, more intensive management, and electronic identification tags. Our members are convinced that making these changes to develop a differentiated product for the consumer creates more value.

#### **Shared Risk and Reward**

Traditionally, if a rancher manages the animal from start to finish, he assumes virtually all the risk. In our system, we have created a financial model that shares risk between segments. This has allowed our ranch members much more flexibility since they now have a true partner who shares a portion of the risk of what can be a volatile business.

The beef industry, and ultimately the American consumer have suffered because of the commodity cattle marketing system, a system that does not send clear economic signals relative to value. Traditionally, poorer cattle are unfairly rewarded as they have been accounted for in the “average.” At the same time, higher-quality cattle have not been adequately rewarded for the same reason. This commodity system has resulted in a very inconsistent product for the consumer. In fact, research indicates that one in four eating experiences of commodity beef is unacceptable by the consumer. Our system has been designed to recognize value, reward those responsible for the creation of this value, and provide the consumer an exceptional eating experience every time.

As I mentioned earlier, each segment, the rancher, the feed yard, and the packer/processor, is a part of the system and therefore receives a portion of the added value. The ban on packer ownership would create restrictions that would force us to dismantle what is a very successful system.

#### **Summary**

There are volumes of consumer research indicating that beef demand has halted its decline and in fact turned the corner and is on the way up. A significant portion of this increase in demand has been the result of the successful implementation of a number of branded programs which are now bringing more beef value to the consumer. As I said earlier, our program is neither rocket science nor a silver bullet. We have a long way to go and I ask that you give careful consideration to restricting our freedom and ability to implement a business strategy that could result in strengthening the long-term viability of cattle producers.

I would also like to share with you that Ranchers Renaissance has been invited to participate in a coalition of cattle alliances. There are now 22 participants in the Cattlemen's Alliance Coalition. Though each of these alliances belonging to the coalition is structured differently, the vast majority would be in jeopardy if the ban on packer ownership became law.

Eric Davis with the National Cattlemen's Beef Association has outlined a series of recommendations from the Price Discovery Think Tank that is supported by the membership of Ranchers Renaissance. I would encourage support for the study requested to evaluate the meat protein complex. It appears that the results from such a study would provide all of us with an objective foundation from which we could work together and make appropriate changes within our industry if necessary.

Chairman Harkin, thank you for the opportunity to participate in this hearing and I would be happy to answer any questions you may have.



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**DOCUMENTS SUBMITTED FOR THE RECORD**

JULY 16, 2002

Statement of Senator Max Baucus  
Committee on Agriculture, Forestry, and Nutrition  
Full Committee Hearing on Packers and Stockyards Issues  
July 16, 2002

Mr. Chairman, thank you for holding this very important hearing today.

The Packers and Stockyards Act is one of the strongest antitrust laws ever written. Unfortunately, it is only as good as its enforcement and I believe that the enforcement of the Packers and Stockyards Act has been neglected for far too long.

The behavior of the livestock markets directly impacts my home state significantly. It would be hard to find a Montanan who isn't impacted either directly or indirectly. That is how tied my state's economy is to agriculture. Montana is home to more than 2.4 million cattle and calves. In 2000 (the most recent available data), Montana livestock producers received more than \$1.1 billion in income from cash receipts. More than half of my state's economy is agriculture and more than half of the agricultural industry is livestock.

Montana is currently suffering from a relentless drought for the last four, five, or six years depending upon where you live in the state. The cattle producers have tried to hang on to their herds for as long as they could but many are now being forced to liquidate into a market that is not giving them what their product is worth. This is just not fair.

Market issues are difficult to get ones arms around as there are so many moving pieces. We must be smart, bold, and brave about our actions in order to protect the future of our nation's livestock producers.

I believe that this hearing is a giant step forward in the right direction. We have had hearings on this issue before but I believe we have the critical mass necessary to make real change. The majority of us here today agree that the status quo is not acceptable for the future. We are ready to roll up our shirt sleeves and get to work. I mean really working, asking the tough questions, challenging assumptions, and tradition.

Mr. Chairman, I stand ready to work through these difficult issues.

Thank you.

**United States Senate  
Committee on Agriculture, Nutrition, and Forestry  
July 16, 2002  
Statement of Senator Mike Crapo**

Thank you, Chairman Harkin and Ranking Member Lugar. I appreciate your holding this hearing on Packers and Stockyards issues and the opportunity to submit a written statement. I apologize that because of a death in my family I am unable to attend this hearing in person.

First, I want to thank Senator Larry Craig for his testimony. A rancher, my colleague from Idaho is acutely aware of the problems facing our livestock industry. He has been a leader who has worked to ensure we do not enact legislation that might result in devastating unintended consequences for Idaho's livestock producers.

I also want to thank Eric Davis for his participation at this hearing. Eric is a rancher and feeder from Bruneau, Idaho. He has been before us before, but this time he appears as president-elect of the National Cattlemen's Beef Association. I appreciate his willingness to share his perspective on these issues with the Committee. All the witnesses here today will make an important contribution to our understanding of these issues. I thank them for their willingness to testify.

A thorough examination of both Packers and Stockyards Programs and the impact of proposals to ban packer ownership of livestock are important to the many livestock producers in my state. I am hopeful an objective hearing will allow us to delve deeper into some of the multi-faceted issues surrounding livestock prices; thereby, helping us to craft sound, fair, and effective policy.

I share the concern of many producers in Idaho about the competitive nature of the marketplace. Unfortunately, there is no single answer that will drive the market price of livestock. Perhaps today's hearing will shed some light on how vertical integration has actually affected market prices, how the Grain Inspection, Packers and Stockyards Administration has enforced the Packers and Stockyards Act, what repercussions our efforts may have, and, most importantly, what we can do to help address the crisis facing our nation's independent livestock producers.

There can be no doubt about the increased concentration in agriculture. Likewise, our livestock producers are facing what appear to be artificially low spot market prices. How these relate and how to best address the problem is an issue we must address. Is the Packers and Stockyards Act being effectively enforced? The 2000 General Accounting Office report on the Packers and Stockyards Program made a number of recommendations to improve the effectiveness of investigations of competitive practices. Have the

recommendations been implemented? Has this led to more effective application of the law? Or, is it time we update the Packers and Stockyards Act?

How would a ban on packer ownership affect the marketplace? Will it artificially limit the ability of industry to innovate? Will it result in long-term instability? Or, will it result in increased prices for live cattle? Is there market manipulation and if the Packers and Stockyards Act does not address the problem, is it appropriate to limit captive supplies? And, if so, will a ban affect the viability of a long-term market?

This is a difficult issue. There is no silver bullet that will solve the crisis facing independent producers. Nonetheless, it is clear we must take action to address the transparency in the market and if there is not market manipulation to provide instill a trust in the process. Unfortunately, mandatory price reporting has not addressed these issues. I look forward to working with my colleagues on both sides of the issue to work toward price stability and market stability.



U.S. Senator For Minnesota

# PAUL WELLSTONE

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FOR IMMEDIATE RELEASE  
 July 16, 2002

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## Wellstone Calls on For Action on Packer Ownership Ban

(Washington, D.C.)— At a Senate Agriculture Committee hearing today, Senator Paul Wellstone (D-MN) called on Congress to pass a ban on packer ownership of livestock. Committee Chairman Tom Harkin (D-IA) convened the hearing to examine the legislation and USDA enforcement of the Packers and Stockyards Act. During the Senate consideration of the new Farm Bill, Wellstone, along with Senators Charles Grassley (R-IA) and Tim Johnson (D-SD), passed an amendment to limit the ability of livestock packers to own animals just prior to slaughter for the purpose of deflating market prices paid to independent producers. The provision was stripped out during conference committee consideration of the bill. Wellstone said that the Senate Agriculture Committee should reconsider enacting a ban such as the one passed by the Senate last fall.

**“We must restore competition to our livestock markets, and put some freedom back into the free market,”** said Wellstone. **“Through direct ownership and contracts these large packers are controlling the livestock markets for their own benefit and to the detriment for independent producers. This is an anti-competitive practice – a direct manipulation of what should be an open supply and demand market. Independent producers need the packer ownership ban now. If we continue to stand idle and watch control of the world's food supply fall into the hands of the few, family farmers and consumers will be the real losers.”**

Over the past decade and a half, an explosion of mergers, acquisitions, and anti-competitive practices has raised concentration in American agriculture to record levels. In the meat processing industry alone, the top four processing firms for beef, pork and chickens control from 55 to 87 percent of the US market. A recent USDA Grain Inspection and Packers and Stockyards Administration (GIPSA) report estimated captive supplies to be more than 32 percent of the total slaughter of the four largest packers in 1999.

**“The effect of this surge of concentration is that agribusiness conglomerates have increased their bargaining power over farmers,”** said Wellstone. **“When farmers have fewer buyers to choose from, they have less leverage to get a good price. Anybody who has been to an auction knows that you get a better price with more bidders. Moreover, when farmers have fewer buyers to choose from, agribusinesses can more easily dictate conditions that farmers have to meet.”**



UNITED STATES SENATOR • SOUTH DAKOTA  
**TIM JOHNSON**  
 N E W S R E L E A S E



FOR IMMEDIATE RELEASE:  
 July 16, 2002

CONTACT: Bob Martin, 202-224-1643  
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## **Johnson Says Ban on Packer Ownership of Livestock is Key to Restoring Competition**

### *Concentration in Agriculture Sector Intensifying*

**Washington, DC**— Banning large packing companies from owning livestock until 14 days before slaughter is key to restoring competition in the livestock market, U.S. Senator Tim Johnson (D-SD) today told members of the Senate Agriculture Committee during a hearing on his legislation to do that.

The Committee is conducting hearings on the effectiveness of the Packers and Stockyards Act. Johnson's ban on large packing companies owning livestock until 14 days before slaughter would amend the Packers and Stockyards Act. Herried, South Dakota native Herman Schumacher, a livestock producer and livestock auction owner, also testified at the hearing.

"A ban on packer ownership could restore competition, access, and bargaining power to cattle markets for America's farmers and ranchers. I believe America's free enterprise system only works if we have more competition, not less. An independent report indicates that hog and cattle markets have three buyers at best, and one at worst, in any given geographic area. In 2001, 83% of hogs were committed to packers by ownership or contract arrangements. That means only 17% of hogs are in the cash market on any given day. That means the power of the large packing companies is intensifying. My bill would begin to reverse that trend," Johnson said.

Johnson's bill exempts producer-owned co-operatives from the ban, in addition to packing plants that slaughter less than 2% of the national annual slaughter of beef cattle (approximately 740,000 head), hogs (approximately 1,900,000 head), and sheep (approximately 69,2000 head).

"A ban on packer ownership of livestock will not drive packers out of business because most of their earnings come from branded products and companies marketing directly to consumers. However, packer ownership of livestock could drive independent producers out of business because under current market conditions, producers are at the mercy of these large, powerful corporations," Johnson said.

Johnson's bill was added as an amendment to the Senate version of the farm bill, but was stripped out of the final farm bill at the insistence of the House Republican members of the conference committee.

"During Senate debate on the farm bill, I was disappointed that some were fooled by influential packers who made claims that our amendment didn't clarify whether forward contracts could be used as a marketing tool. Forward contracts have NEVER been prohibited by my legislation," Johnson said.

“According to the United States Department of Agriculture, packer concentration has increased 45% in the last 20 years. During that time, the packing industry has aligned with food and retailing conglomerates to amass profits—triple the rate of inflation. If the power of the large packing companies is not checked, there will be even fewer family farmers and ranchers producing livestock 20 years from now. In fact, the packing companies would love to have America’s independent farmers and ranchers working for them as low wage employees. We can not allow that to happen,” Johnson said.

For more information on Senator Tim Johnson visit his website at <http://johnson.senate.gov>. To contact Senator Johnson’s communications office via e-mail, write his Communications Director at [bob\\_martin@johnson.senate.gov](mailto:bob_martin@johnson.senate.gov) or his Deputy Communications Director at [leslie\\_knapp@johnson.senate.gov](mailto:leslie_knapp@johnson.senate.gov).

July 16, 2002

The Honorable Thomas A. Daschle  
Senate Majority Leader  
United States Senate  
Washington, DC 20510

The Honorable Trent Lott  
Senate Minority Leader  
United States Senate  
Washington, DC 20515

The Honorable Tom Harkin  
Chairman  
Senate Committee on Agriculture,  
Nutrition, and Forestry  
United States Senate  
Washington, DC 20510

The Honorable Richard G. Lugar  
Ranking Member  
Senate Committee on Agriculture,  
Nutrition, and Forestry  
United States Senate  
Washington, DC 20510

The Honorable Patrick J. Leahy  
Chairman  
Senate Judiciary Committee  
United States Senate  
Washington, DC 20510

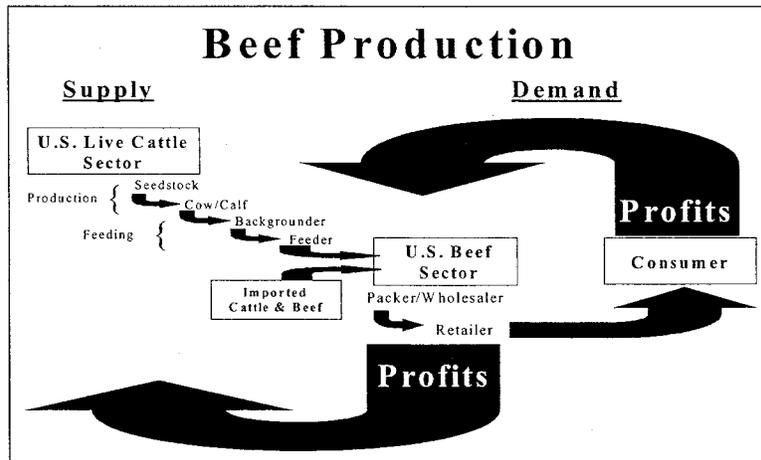
The Honorable Orrin G. Hatch  
Ranking Member  
Senate Judiciary Committee  
United States Senate  
Washington, DC 20510

Dear Majority Leader Daschle, Minority Leader Lott, Chairmen Harkin and Leahy,  
and Ranking Members Lugar and Hatch:

We write to express our concern regarding the functioning of the United States cattle market. We believe the United States Senate Agriculture and Judiciary committees should lead an investigation into the workings of these markets with an eye toward enacting legislation that addresses the concerns of cattle producers across the United States. The severity of the current market situation dictates the need for a more expedient review than what could reasonably be accomplished through administrative channels.

### Structure of the U.S. Cattle and Beef Markets

As you may know, there are several individual sectors within the overall beef industry. The beef industry is broken down between the live cattle sector and the U.S. beef sector. The United States live cattle industry is divided into two sub-sectors: production and feeding. These sub-sectors represent a production chain leading to the cattle industry's end customer – the U.S. beef industry. The U.S. beef industry, in turn, is divided into three sub-sectors: processing, wholesaling, and retailing. These sub-sectors represent a production chain leading to the beef industry's end customer – the consumer. Each of these sub-sectors, in both the cattle and beef industries, is an independent economic unit, i.e., an industry within an industry. They are, however, operationally integrated in order to coordinate the overall industry's final product – consumable beef.



If the marketplace is truly competitive, product value is progressively added within each independent sector, beginning first with the production sector of the cattle industry. Economic pricing signals, driven by consumer demand, are focused at the end of the beef industry's production chain – the retail sector. Thus, the retail sector is the direct recipient of pricing signals that must percolate down the production chain, distributing profits to each of the five integrated sectors.

We are concerned that forces are at work to unravel this framework and we believe that we must look at both the recent fluctuations in the marketplace as well as the function of the marketplace over the last several years to understand what changes are occurring and what action must be taken.

#### **Recent Activities**

In recent months, live cattle markets experienced repeated market collapses following a series of negative events, including announcements of routine FMD investigations. However, traditional market fundamentals would have dictated far less volatility and a market recovery, but this has not occurred. According to USDA-ERS, U.S. beef production hit a record high in 2000. During April – May of that record-breaking year, Choice retail beef prices were \$3.07/lb. (retailer share), boxed beef prices were \$1.24/lb. (packer share), and fed cattle prices were \$.72/lb. (producers share). Production levels in 2002 are currently 2 percent below the 2000 record. However, in April – May 2002, Choice retail beef prices are \$3.30/lb., boxed beef prices remain around the \$1.20/lb. level, and fed cattle prices are in the mid-\$.60/lb. range. Traditional economic market fundamentals would predict that live cattle prices should have increased, or at least have stayed the same, during this period versus the 10–15 percent decline that actually occurred. This comparison of current prices to prices received during the record-breaking beef production year of 2000 demonstrates the irrational functioning of our industry's market structure.

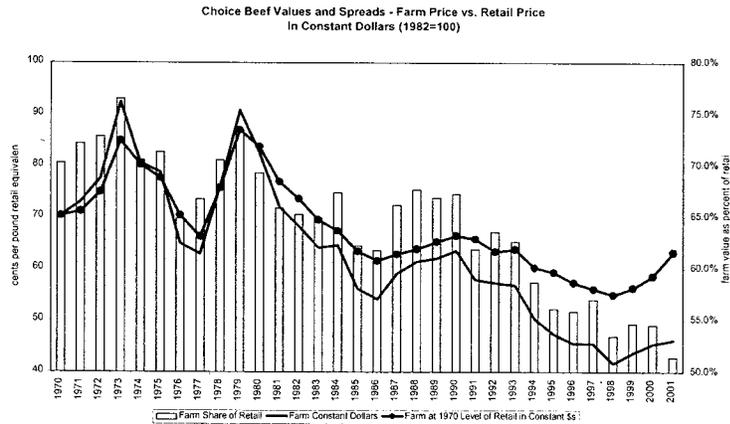
With April – May 2002 U.S. beef production 2 percent below 2000, and with increasing beef demand, continued growth in the U.S. population, and a USDA-ERS forecast for 2002 export gains over 2001, a 7 percent increase in the Choice retail beef price is understandable. However, a 10-15 percent decline in fed cattle prices to the low to mid-\$.60s price range does not fit the equation. There can be no doubt that the traditional market fundamentals, which have historically rewarded U.S. cattle producers with higher prices, are being frustrated.

Also unexplained during this period of depressed live cattle prices is the May 23, 2002, report by Data Transmission Network (DTN) Livestock that the gross margins earned by beef packers are higher than anytime recorded since 1993. While there may not be one single factor that has caused the price differential between the retail and production sectors, more than likely it is the cumulative result of several factors. Contributing factors may include: captive supply impacts, distortions in the futures market, a record high increase in packer concentration levels, and an increase in market power at both the wholesale and retail level. In addition, imports are impacting US cattle markets as reported by Lynn M. Bragg, Chairman of the International Trade Commission (ITC) during the 1999 ITC investigation on Live Cattle from Canada, who said at that time that packers are using imports to suppress domestic live cattle prices.

**Activities of Last Several Years**

In addition, we are concerned about the increasing concentration in the marketplace that we believe has impacted cattle prices going back to at least 1993. During the twenty years prior to 1993, the prices received by the cattle industry were closely correlated with the prices received by the beef industry, with cattle industry prices rising and falling in conjunction with beef industry prices. This relationship suggested that prices received by the cattle industry were responsive to consumer demand and, therefore, responsive to competitive market signals. During this period, the cattle industry captured a majority share of the value of the final product, approximately 60 percent, and the beef industry captured a minority share, approximately 40 percent of the value of the final product.

According to our data, this relationship ended in 1994. Beginning in 1995 and continuing today, the percentage shared by each industry has been inverted, with the beef industry now capturing the majority of the final product value, 54 percent in 2001, and the cattle industry capturing a minority share, 46 percent. This radical transformation of the relative economic positions of the two industries occurred during a period marked by increased retail demand, rising retail prices, and a declining supply of domestic inventories. We believe a competitive market with efficient firms would not operate this way. According to USDA data, concentration in the meat packing industry has increased significantly during this time. Specifically, the four-firm concentration ratio for steer and heifer slaughter was 36 percent in 1980. This concentration measure has increased steadily since then, increasing to 50 percent in 1985, 72 percent in 1990, 79 percent in 1995 and 81 percent in 1999 (the last year for data reported by USDA GIPSA on this measure).



The foregoing challenges facing U.S. live cattle markets have not gone unnoticed. They have, however, gone unanswered for several years. The March 2002 report issued by the General Accounting Office (GAO), Economic Models of Cattle Prices, found that in reference to

the beef industry, “. . . no other manufacturing industry showed as large an increase in concentration since the U.S. Bureau of the Census began regularly publishing concentration data in 1947 . . .” The GAO further referenced a 1996 report by the Grain Inspection Packers and Stockyards Administration (GIPSA) stating in regard to the 1996 report, “This report also stated that while the body of evidence from the literature was insufficient to support a finding of noncompetitive behavior, GIPSA also could not conclude that the industry [beef industry] is competitive.”

In their November 1999 Final Determination on Live Cattle from Canada, three of the six ITC commissioners found the impacts of beef industry concentration deserving of comment, notwithstanding the non-jurisdictional nature of their comments. Commissioner Carol T. Crawford noted, “. . . there is considerable concentration in the packing industry . . . which can and does exert significant influence over prices for cattle.” Commissioner Thelma J. Ashley noted, “. . . the beef packing industry is heavily concentrated . . . [which] leads to unequal bargaining positions between the two groups [packers versus feedlot operators] . . . This disparity in bargaining positions enables . . . beef packers to have a more significant influence on price levels . . .” Then-Chairman Lynn M. Bragg noted, “The concentration of packers increases the packers’ leverage relative to cattle prices.” The challenges facing the U.S. live cattle market are widely known, now is the time to effectively and expeditiously address these challenges.

### **Conclusion**

We respectfully call upon the U.S. Senate Agriculture, Nutrition and Forestry Committee and the U.S. Senate Judiciary Committee to conduct an immediate and thorough investigation into the cause or causes of why our U.S. cattle industry markets have failed to properly respond to the favorable competitive market signals received and enjoyed by the beef industry since 1994.

In addition, the investigation should look into the cause or causes of why U.S. cattle industry markets have suffered repeated collapses during the past few weeks and whether the same forces that adversely influenced our markets in 1993 have become more pronounced, or if new forces have entered the marketplace to effect the more recent collapses.

As a part of this investigation, we urge the respective U.S. Senate Committees to evaluate the packing, wholesaling, and retailing industry structures and conduct and to recommend statutory changes to facilitate proper market operation.

We stand ready to work with you in any way to help ensure that the livestock industry remains competitive.

Sincerely,

#### **National Associations:**

American Agriculture Movement (AAM)

American Corn Growers Association

Consumers Federation of America (CFA)

National Catholic Rural Live Conference  
 National Consumers League (NCL)  
 National Farmers Organization (NFO)  
 National Farmers Union (NFU)  
 Organization for Competitive Markets (OCM)  
 Rural Advancement Foundation International-USA-  
 R-CALF United Stockgrowers of America (R-CALF USA)  
 Women Involved in Farm Economics (WIFE)

**State Associations:**

Colorado Cattlemen's Association  
 Dakota Resource Council  
 Kansas Cattlemen's Association  
 Kansas Hereford Association  
 Kansas National Farmers Organization  
 Idaho Rural Council  
 Independent Cattlemen's Association of Texas  
 Missouri Stockgrower's Association  
 Montana Cattlemen's Association  
 Nebraska Cattlemens, Inc.  
 Nevada Live Stock Association  
 New Mexico Cattle Growers' Association  
 North Dakota Stockmen's Association  
 South Dakota Stockgrowers Association  
 American Agriculture Movement of Texas  
 Virginia Angus Association  
 Virginia Livestock Marketing Association  
 Washington Cattlemen's Association  
 Wyoming Stock Growers Association

**Local/County Associations:**

Baker County Livestock Association (Oregon)  
 Beartooth Stock Association (Montana)  
 Bitterroot Stockgrowers Association (Montana)  
 Burleigh County Farm Bureau (North Dakota)  
 Cheyenne County Cattlemen's Association (Colorado)  
 Elbert Douglas Livestock Association (Colorado)  
 Eastern Montana Angus Association  
 Eastern Montana Livestock Association  
 Gilpin-Jefferson County Livestock Association (Colorado)  
 Glacial Ridge Cattlemen's Association (Minnesota)  
 Grant County Stockgrowers (Oregon)  
 Grant County Cattlemen's Association (Washington)  
 Houston County Cattlemen's Association (Minnesota)  
 Kit Carson County Cattlemen's Association (Colorado)  
 Kittitas County Cattlemen's Association (Washington)

Lincoln County Stockgrowers Association (Colorado)  
Madera County Cattlemen's Association (California)  
Minnesota Cattlemen's Association  
Northern Virginia Angus Association  
Okanogan County Cattlemen's Association (Washington)  
Pike's Peak Cattlemen's Association (Colorado)  
Pueblo County Stockmen's Association (Colorado)  
Southern Colorado Livestock Association  
Spokane County Cattlemen's Association (Washington)  
Stevens County Cattlemen's Association (Washington)  
Washington County Cattlemen's Association (Colorado)  
Yuma County Cattlemen's Association (Colorado)

**Marketing Associations**

Livestock Marketing Association  
South Dakota Livestock Auction Markets Association

**Regional Associations**

American Indian Livestock Association  
Western Organization of Resource Councils (WORC)

# WORC

*Western Organization of Resource Councils*

## **Statement of Shane Kolb**

*for the*

## **Western Organization of Resource Councils**

***Thursday, September 21, 2000***

### ***USDA Forum on Captive Supplies***

I am Shane Kolb, a fourth generation rancher in Perkins County near Meadow, South Dakota. We raise registered and commercial Angus cattle and a few too many horses. Currently I serve as the Chair of the Agriculture Issue Team of the Western Organization of Resource Councils – WORC. WORC is comprised of grassroots organizations from six western states.

Not only do I represent WORC, but also ranchers, farmers and consumers who support our proposal for controlling captive cattle supplies and restoring competition in livestock markets by enforcing the Packers and Stockyards Act of 1921.

The erosion of family agriculture in this country, and the corresponding movement toward concentration in the food processing industry, is not the result of inevitable market forces. Rather it is the result of powerful corporate influence on Congress and the federal government. Farmers, ranchers and consumers ultimately pay the price for this influence with the disintegration of rural life and unsafe food, while a handful of corporations reap profits.

WORC filed a Petition for Rulemaking with Secretary Glickman in October 1996, requesting that USDA use its authority under the Packers and Stockyards Act to restrict the use of captive supplies of cattle by beef packers.<sup>1</sup>

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<sup>1</sup> WORC developed the Petition for Rulemaking on Captive Supply Procurement Practices as a remedy for two kinds of anticompetitive practices:

- The potential for price discrimination and undue preferences in violation of Section 202, subsections (a) and (b) of the Packers and Stockyards Act; and
- The potential for intentional or effective price manipulation in violation of Section 202, subsection (e).

WORC's petition proposed implementation of rules which would require packers to offer firm, fixed base prices on forward contracts and require that cattle acquired by forward contract or owned outright by packers be offered for bid in an open, public market.

The cattle-buying practices of the major packers are in violation of the Packers and Stockyards Act and have destroyed our livestock markets. The mechanism packers use to exercise their market power is commonly known as *captive supplies*. These are cattle either owned directly by packers or controlled through unpriced forward contracts. The use of captive supplies in a highly concentrated market has led to uncompetitive conditions in the markets for fed cattle.

The farm share of the consumer's beef dollar, which was 60% ten years ago, was just 47% in July. Since WORC's petition for rulemaking was published for comment in the Federal Register in January 1997, the retail price of choice beef has increased 11%. The farmers' share of the retail price, in dollars and cents, is virtually unchanged over that time. The packers' share, meanwhile, has increased 91% (Chart 1).

The Act says that it is unlawful for a packer to *engage in or use any unfair, unjustly discriminatory, or deceptive practice or device*. Packers unfairly and unjustly discriminate against some producers by offering and agreeing to forward contracts and marketing agreements only with select producers, and in failing to offer them openly and publicly. Packers' use of such contracts with prices based on thin cash markets, which they can and do influence, is an unfair and deceptive practice or device, but USDA has not enforced the law.

The Act says a packer may not give *undue or unreasonable preference or advantage to any particular person or locality in any respect whatsoever, or subject any particular person or locality to any undue or unreasonable prejudice or disadvantage in any respect whatsoever*. Current marketing agreements and forward contracts often give preference to some cattle feeders over others with access to markets and timely slaughter. Packer-ownership of cattle supplies gives undue preference to the stockholders of packing companies with access to markets and timely slaughter. These practices violate the Act, but USDA has not enforced the law.

The Act says packers may not *engage in any course of business or do any act for the purpose or with the effect of manipulating or controlling prices, or of creating a monopoly*. The packers' strategic use of captive supplies, and the use of forward contracts and marketing agreements without a fixed base price, has had the effect of manipulating or controlling prices, in violation of the Act.<sup>2</sup> But USDA has not enforced the law.

WORC's petition for rulemaking asks the Secretary of Agriculture to adopt rules under section 202 of the Packers and Stockyards Act. First, forward contracts and marketing agreements would have to have a fixed base price.

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<sup>2</sup> This was demonstrated by USDA's own study, which shows that formula base-priced marketing agreements are associated with much lower cash market prices than are fixed base priced forward contracts.

This part of the rule is designed to eliminate the problem identified by the minority report of Secretary Glickman's Advisory Committee on Agricultural Concentration, which said, "the problem with formula pricing... is not a problem of value pricing. Rather, the problem lies in the base from which the carcass value is calculated. In all the methods currently used, the packer has the power to artificially lower the base price from which premiums and discounts are calculated."

Similarly, as Dr. Purcell recommended in a white paper to the National Cattlemen's Beef Association in May, 1999:

"Any type of formula price arrangement, including proprietary business arrangements, that ties the final price to some observable cash market indicator or plant-paid prices at or near the time of delivery does not get the cattle feeder involved in price discovery... [F]ormula pricing that ties to a cash price or cash series damages the integrity of the pricing process... I am opposed to captive supply arrangements which have a perverse set of incentives with price tied to a cash market the market is active in and feel the industry would be better off without such arrangements."<sup>3</sup>

Secondly, the rule requires forward contracts to be offered for bid in an open, public manner. This requirement works for both the packer and the producer. It preserves the ability of packers and feeders to enter into forward contracts and agreements. It prevents intentional or unintentional discrimination among producers by packers. Everyone would have an equal opportunity to compete for and win a contract with the packer in an open market, while effectively increasing the number of bidders. If packers had to compete against each other openly in a public auction, then forward contracts and marketing agreements would not reduce competition, as they do now.

Lastly, our proposal would require packers to offer cattle they feed or own for bid in an open, public market. Packers could still win the bid, but this would turn fed cattle from price breakers to price makers, and remove the preferential and discriminatory potential of packer-feeding.

These are the things the WORC rule would do.

- 1) Provide fixed base prices on forward contracts and marketing agreements.
- 2) Ensure open and public bidding on forward contracts.
- 3) Require packer-owned cattle be offered for open and public bidding.

I want to be clear about what it would *not* do. It would *not* prohibit the use of forward contracts, marketing agreements, or even packer-ownership of cattle. Packers would still be able to use these methods to coordinate supply in advance to keep their plants running efficiently. Feeders would still be able to enter into agreements to line up access to

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<sup>3</sup> Purcell, Wayne D. *White Paper on Status, Conflicts, Issues, Opportunities and Needs in the U.S. Beef Industry*, May 1999. Research Institute on Livestock Pricing, Virginia Tech, Research Bulletin 5-99.

markets and be paid for quality. The WORC rule is designed to address only the negative aspects of captive supplies which lead to violations of the Packers and Stockyards Act.

This is not a debate about efficiency. It is a debate about fairness, about enforcing the law, about what is right and wrong. Robbing Qwik-shops is a fairly efficient way to get money, but that doesn't make it legal.

During the past four years, we have presented Secretary Glickman on several occasions with legal, economic, and public policy arguments he needs to advance this proposal.<sup>4</sup> On July 28 of this year, he again requested more information by means of this forum so he could decide whether or not to advance this proposal.

While USDA has sat on our proposal, packers have catapulted the use of captive supplies from 19% to 50%. During certain weeks, captive supplies approach 100% of livestock slaughtered, particularly in the Northwestern United States. Studies have proven these levels of captive supplies are costing cattle producers over a billion dollars annually.

Increased captive supply levels have put livestock producers and feeders under severe financial pressure. While retail beef prices are on the rise, the producers' share of the consumer dollar is at a record low. Many farmers and ranchers have lost their livelihoods in the last four years, and consumers are being ripped off due to the monopolistic power of the major packers.

There is only one place to put the blame for these facts: the unwillingness of USDA to enforce existing antitrust laws, thus allowing erosion of competition due to increased packer concentration.

Secretary Glickman has the power and the duty to enforce the Packers and Stockyards Act. The Secretary's failure to act is, in effect, approval and endorsement of the increasing monopolization, price manipulation and discrimination in the livestock industry.

Thank-you.

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<sup>4</sup> This information was presented to USDA:

- In the petition itself when it was presented to the Secretary in October 1996;
- In comments on the petition during the comment period, in April 1997;
- In a detailed response to other commenters in June, 1997;
- In analyses prepared for USDA by consulting economists concerning USDA's Red Meat Concentration Study, in 1998, and the Texas Cattle Procurement Study, earlier this year; and
- In several meetings with the Secretary and USDA staff over the last three years.

## Responses to questions from USDA

*1.1 What evidence or information do you have that demonstrates that forward contracting or packer ownership of livestock manipulates, controls prices or has other anti-competitive effects, or is likely to do so in the future?*

WORC has submitted references and analysis demonstrating that these kinds of captive supplies are likely to have the effect of manipulating or controlling prices or having other anticompetitive effects several times during the last four years. Two pieces deserve special note here.

First, Professor Cathy Durham reviewed a report on captive supplies (by Ward Koontz, and Schroeder) in GIPSA's Red Meat Concentration Study.<sup>5</sup> She concluded that the study supported a finding that the aggregate impact of captive supplies on cattle prices was as high as \$527 million in 1993 (the year studied). Most importantly, Professor Durham argued that the report provided evidence that packers used captive supply strategically, not just to improve efficiency, based on the timing of packers use of different kinds of forward contracts.

Second, Dr. John Cranfield of the University of Manitoba reviewed the Texas Cattle Procurement Study prepared for GIPSA by Azzam and Schroeter. Noting the "robust relationship Azzam and Schroeter found between captive supply levels and cash cattle prices, Dr. Cranfield concluded that "WORC's petition requiring packers to bid on captive supply contracts in an open market setting would be the most appropriate means to eliminate the scope for beef packers to abuse the negative relationship between captive supplies and cash prices." Extrapolating from the association found by Azzam and Schroeter to current captive supply levels, we estimate that the use of captive supplies by packers will reduce prices paid to producers for fed cattle by \$1.44 billion this year alone.

In addition to the long list of studies demonstrating the intuitively obvious relationship between increased captive supply levels and reduced prices, there are some indirect pieces of evidence. For example, since producers noted an increase in the aggressive use of captive supplies by packers in the Spring of 1994, packers have reported relatively high profit levels and the farm-wholesale price spread has widened significantly, in a manner not explained by the typical cyclical variation in price spreads. Since WORC's proposal was published for comment in the Federal Register in January, 1997, the packers' share of the consumer dollar has nearly doubled. Over the same period, the percentage of cattle marketed in the major cattle feeding states under what USDA's Agricultural Marketing Service calls "additional movement", and what we call captive supply – has grown from 19% to just under 50%.

Characteristics of the cash cattle market also lend support to the notion that captive supplies have anti-competitive effects. Packers with captive supplies lined up can stay out of the cash market for long periods. For the last few years, virtually all of the cash trade

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<sup>5</sup> Letter from Catherine A. Durham to Keith Collins, July 1998.

for fed cattle occurs in a weekly stampede, estimated by observers at between 15 minutes and 2 hours, all in one day. Since cattle reach ideal slaughter weight daily, and packers slaughter cattle daily, the 30-minute marketing window is evidence of anticompetitive forces in the market. Similarly, the convention of whole-dollar bidding, observable virtually every day in public and private market reports, is a sign of a dysfunctional market. Finally, a frequent market convention gives a right of first refusal to the first packer who makes a bid, another anticompetitive aspect of the way cattle markets currently operate.

*1.2 Would the prohibition of certain types of captive supply or of packer ownership of livestock effectively limit packer market power to affect market price?*

Yes. As explained in our comments on the petition, the requirement in our proposed rule that captive supply contracts be negotiated only through open public bidding would effectively increase the number of bidding packers. Requiring packer fed cattle to be offered in an open public market would, similarly, increase bidding. By prohibiting agreements without a fixed base price, WORC's proposal would reduce the ability of packers to affect the cash price through strategic use of captive supplies. WORC has previously supplied references to several of the many studies demonstrating the positive relationship between the number of bidders and prices.

*1.3 What other consequences would result from such a prohibition?*

Adoption of WORC's proposed rules would:

- Encourage value-based pricing by affording more producers the opportunity to participate in publicly traded forward contracts that include grade, quality, and other value-based premiums.
- Allow small producers who otherwise might not have access to benefit from forward contracts.
- Encourage public and electronic trading of greater numbers of cattle, providing greater price transparency.
- Ensure that packers cannot pay discriminatory prices or give undue preference to one producer of like quality cattle over another.
- Continue to allow packers to coordinate their slaughter supplies in advance to ensure efficient running of their plants.

*2. What are the positive and negative effects of the various marketing arrangements (forward contracts, marketing agreements, packer feeding) on maintaining and sustaining competitive markets? Please explain how market effects, particularly with reference to price discovery and transparency, support your point of view.*

In theory, all types of arrangements help rationalize packer scheduling of cattle to increase efficiency. That is why WORC's proposal does not prohibit such arrangements. Captive supply agreements as currently constructed, however, cannot maintain

competitive markets, because there is no competition for them. That is why WORC's proposal merely requires all such arrangements to be subject to the discipline of the open market, instead of prohibiting captive supply arrangements. There are no pro-competitive aspects of marketing arrangements that we know of which would be limited by WORC's proposal.

The reason for this is that packers could still line up supplies, under our proposal, by bidding for contracts in an electronic or other auction. WORC's proposed rule is necessary because without it, the packers will not participate in electronic auctions for fed cattle – despite the fact that they are teaming up to force wholesalers and retailers to buy meat from their own electronic auction site on the web. When asked about his company's lack of interest in electronic markets nearly ten years ago, Excel's Del Allen told a *Beef Today* reporter, "We don't buy at auctions. Any auction." As far as we can determine, that attitude by the major packers continues to this day.

Forward contracts and marketing agreements lock up supply without a negotiated price. These agreements would be less of a problem if the base price were fixed, which is why our rule allows contracts with a fixed base price. Purcell and others have made the case against using average plant costs or USDA average prices as the base price in formula or grid arrangements.

As currently constructed, forward contracts, marketing agreements and packer-fed cattle effectively reduce competition by reducing the number of actual bids for cattle in any given week – the agreements become "price breakers." WORC's proposal allows contracts, but requires open public bidding, which preserves the alleged efficiencies of captive supplies while prohibiting those practices which allow packers to use captive supplies to manipulate price.

*3 There are two sides to the argument on consolidation and concentration in the marketplace. What evidence do you have to support a contention that greater efficiencies result from consolidation in the marketplace? What evidence do you have to support a contention that consolidation or concentration result in a decline of competition in the marketplace?*

To our knowledge, no one argues that increasing concentration leads to increasing competition, or that increasing concentration can lead to an increase in competition, and competition is the best way to achieve efficiencies that are in the interests of all market participants. The question, then is whether the decline in competition accompanying increased consolidation and concentration is or is not outweighed by the alleged efficiency advantages of consolidation and concentration.

I have already noted the information we have previously submitted to USDA supporting the contention that consolidation and concentration result in a decline in competition in the marketplace. I would like to note here that the body of evidence we and other proponents of our proposal have cited completely contradicts the contention, frequently

heard from the packing industry, that “study after study” finds no serious problem from market concentration or captive supplies. The truth is the opposite: study after study has demonstrated the common sense notion, consistent with basic economic theory, that very high levels of concentration and captive supply agreements that very high levels of captive supplies as found in the beef industry today lead to lower prices for producers, due to less competition in the packing sector.

I would also like to note that WORC’s proposal is designed to preserve the legitimate efficiencies which advance the interests of all parties in the livestock industry. It does not follow that, because we seek controls on some types of captive supply agreements, that our proposal would eliminate any efficiencies which may benefit the industry.

Finally, I would like to point out that the word “efficiency” is not found in the Packers & Stockyards Act. We did not believe we were obliged to accommodate alleged efficiencies in proposing rules to further the Act’s enforcement. Nonetheless, we tried to accommodate the interests of packers and feeders who have legitimate uses for such arrangements as we designed the WORC rule. The rule would allow forward contracts, and even packer ownership, if the cattle and contracts are offered for bid in an open, public market.

*4. What, if any, further regulatory action should be considered by USDA under the P&S Act to reflect structural changes in the livestock sector?*

WORC believes USDA should adopt our proposal to bring regulation of cattle procurement into the 21<sup>st</sup> century. Adoption of WORC’s proposal would also help define price discrimination. By trading forward contracts and marketing agreements in an open public manner as defined WORC’s proposed rule, all producers who could meet the requirements of the contract would have equal opportunity to accept a forward contract offer made by a packer.

WORC also supports a ban on packer feeding, a step that is more comprehensive than the regulation we have proposed in our petition. While we believe our proposal would reduce the most egregious anticompetitive effects of packer feeding, the practice poses major problems in the hog industry as well as the cattle industry.

*5. Is there any evidence demonstrating the link between the degree of openness and competition in livestock markets and the economic sustainability of rural communities?*

Reduced openness and competition, in markets where the balance of power is one-sided, leads to reduced income on the side with less market power – that is, the farmer and rancher. Walter Goldschmidt’s studies (and those which have followed up on his findings) demonstrate that rural communities with relatively unconcentrated, local ownership of land and resources are healthier and more sustainable than those dominated by centralized, corporate, absentee-owned farms.

Rather than review that literature, a more pertinent source of information on this question is the report of Secretary Glickman's National Commission on Small Farms, called *A Time to Act*, which concluded that increased openness and competition were in the interests of agricultural sustainability. The National Commission on Small Farms unanimously recommended adoption of WORC's petition for rulemaking as a result.

I also refer you to the list of 170 organizations from rural communities across America who have endorsed WORC's proposal. Their endorsement indicates they share the conclusion of the National Commission on Small Farms, that increased openness and competition in the livestock industry will increase the economic sustainability of rural communities.

# WORC

*Western Organization of Resource Councils*

## **Statement of Skip Waters, Chairman**

### **Western Organization of Resource Councils**

***Tuesday, July 16, 2002***

#### ***Unites States Senate Committee on Agriculture***

The Western Organization of Resource Councils (WORC) appreciates the opportunity to submit testimony on the proposed ban on packer ownership of livestock, captive supply reform, and the United States Department of Agriculture's enforcement of the Packers and Stockyards Act. WORC is a network of grassroots organizations from seven states that include 7,000 members and 45 local community groups.

Meatpackers are acquiring an increasing percentage of the cattle and hogs they slaughter through arrangements known as "captive supplies" – livestock that packers either own themselves, or control through contracts with farmers and ranchers. These livestock are called *captive* because they are tied to one packer instead of being subject to normal market forces of supply and demand.

Four companies control more than half of all U.S. hog slaughter and more than 80% of U.S. fed cattle slaughter. In such a concentrated market, buyers (the packers) can use captive supplies to manipulate markets – much as Enron is alleged to have used its dominant market share and unregulated forward contracts to manipulate energy markets. The estimated cost to family farmers and ranchers from the increased use of captive supplies amounts to more than \$1 billion per year for cattle alone.<sup>1</sup>

WORC and its member groups have been working to identify problems in our livestock markets and to develop solutions since the late 1980's, when our members became concerned about the rapid increase in market concentration. The share of U.S. fed steer and heifer slaughter held by the top four packers had recently shot up above 80%. Our members, other cattle producers, and leading economists expressed concerns that such high levels of market concentration, in combination with increasing vertical integration in the form of packer ownership of cattle and forward contracting, threatened the continued openness and competitiveness of cattle markets.

For the next several years, we worked to bring this problem to the attention of the Justice Department, USDA, and our members of Congress. In the spring of 1994, fed cattle prices

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<sup>1</sup> WORC estimate based on analysis of USDA figures by Oregon State University Prof. Catherine Durham.

dropped precipitously. Anecdotal evidence and market reports suggested that the use of captive supplies by packers increased dramatically at the same time. In response, WORC organized meetings in auction yards and town halls across the Great Plains. Out of those meetings, WORC developed a moderate, common sense proposal to deal with the problem of captive supplies, without banning forward contracts outright.

In 1996, WORC submitted this proposal as a Petition for Rulemaking on Captive Supply Procurement Practices to the Department of Agriculture, seeking adoption of rules under Section 202 of the Packers and Stockyards Act. USDA has never acted on the petition's recommendations. The straightforward rules proposed in the petition would serve as a remedy for two kinds of anticompetitive practices:

- The potential for price discrimination and undue preferences in violation of Section 202, subsections (a) and (b) of the Packers and Stockyards Act; and
- The potential for intentional or effective price manipulation in violation of Section 202, subsection (e).

The petition asked USDA to adopt rules to require forward contracts for procuring cattle for slaughter to contain a firm base price that can be equated to a fixed dollar amount on the day the contract is signed, and to require forward contracts, and cattle owned or fed by packers, to be offered for sale in an open, public market.

More than 1,600 cattle producers and consumers, responding to a Federal Register notice seeking comments, supported WORC's proposal; they outnumbered opponents by 33 to 1. Organizations supporting the proposal represent hundreds of thousands of producers and consumers. The minority report of Secretary Glickman's Advisory Committee on Agricultural Concentration supported the proposal, as did the Secretary's National Commission on Small Farms.

After years of meetings, studies, and accumulated evidence, culminating in a forum on captive supplies sponsored by USDA's Grain Inspection, Packers and Stockyards Administration in Denver in September of 2000, the proposal still languishes at USDA. Under the last two Administrations, USDA has refused to either approve or reject the petition, or to release documents related to it. USDA taken no other steps to update its regulations to deal with changing marketing practices and tools developed by packers and feeders, a need Congress anticipated and provided for when it enacted the Packers and Stockyards Act in 1921.

Instead, USDA has stumbled around blindly, occasionally attempting to enforce its antiquated rules on a case-by-case basis – and usually losing. As a result, USDA has taken no action at all to effectively address the discriminatory and manipulative effect of captive supplies, despite the clear language of Section 202 of the Packers and Stockyards Act.

Of course, the problem has not gone away. The percentage of cattle acquired by packers through contracts without negotiated prices and through outright packer ownership has continued to increase.<sup>2</sup> Last Friday, July 12, USDA's Agricultural Marketing Service reports indicate that

<sup>2</sup> USDA's Packers and Stockyards Administration and Agricultural Marketing Service do not agree on how to define or measure captive supplies, but it is indisputable that captive supplies have increased.

well over half of the cattle delivered to U.S. plants for slaughter were acquired through contracts with no negotiated price. The farm share of the consumer's beef dollar, which was 60% twelve years ago, fell to just 42% in May of this year. Put another way, the producer's gross share of the money consumers spend on cuts of choice beef at retail has declined 30%. USDA has failed to address the market imbalances and dysfunctions that allow packers and retailers to capture such large, increasing, and unwarranted shares of the consumer beef dollar.

The Packers and Stockyards Act says that it is unlawful for a packer to "engage in or use any unfair, unjustly discriminatory, or deceptive practice or device." Packers unfairly and unjustly discriminate against some producers by offering and agreeing to forward contracts and marketing agreements only with select producers, and in failing to offer them openly and publicly. Packers' use of such contracts with prices based on thin cash markets, which they can and do influence, is an unfair and deceptive practice or device, but USDA has not enforced the law.

The Act says a packer may not give "undue or unreasonable preference or advantage to any particular person or locality in any respect whatsoever, or subject any particular person or locality to any undue or unreasonable prejudice or disadvantage in any respect whatsoever." Current marketing agreements and forward contracts often give preference to some cattle feeders over others with access to markets and timely slaughter. Packer-ownership of cattle supplies gives undue preference to the stockholders of packing companies with access to markets and timely slaughter. These practices violate the Act, but USDA has not enforced the law.

The Act says packers may not "engage in any course of business or do any act for the purpose or with the effect of manipulating or controlling prices, or of creating a monopoly." The packers' strategic use of captive supplies, and the use of forward contracts and marketing agreements without a fixed base price, has had the effect of manipulating or controlling prices, in violation of the Act.<sup>3</sup> But USDA has not enforced the law.

In the face of these failures by USDA, WORC asks this Committee to reinvigorate the Packers and Stockyards Act by adopting amendments to the Act. Since USDA will not use the tools Congress gave it in 1921, Congress must act to give USDA new tools, and then closely monitor how it uses them.

We urge this Committee, the Senate and the Congress to end the price-manipulating abuses caused by what Iowa State economist Neil Harl calls the "deadly combination" of high market concentration and vertical integration in our cattle markets. We urge adoption of Senator Johnson's legislation to ban packer ownership of livestock, and Senator Enzi's bill, S. 2021, to take the "captive" out of captive supplies.

Banning packer ownership is a critical reform, which WORC strongly supports, but it deals with only one part of the problem. It does not address the secret, Enron-style forward contracts and marketing agreements through which most hogs and nearly half of all cattle are transferred from

<sup>3</sup> This was demonstrated by USDA's own Red Meat Concentration study, which shows that formula base-priced marketing agreements are associated with much lower cash market prices than are fixed base priced forward contracts.

producers to packers<sup>4</sup>. Senator Mike Enzi (R-Wyoming) introduced S. 2021, the Captive Supply Reform Act, to address these other kinds of captive supplies – *without* prohibiting their use.

S. 2021 would make two reforms to restore open, fair competition to the market for livestock contracts. S. 2021, the Captive Supply Reform Act, would:

- Require a fixed base price in formula contracts.
- Require that contracts be traded in open, public markets – no more secret deals.

Most marketing agreements for cattle and hogs do not contain a negotiated price. Instead, the price is based on a reference price that the packer can influence – such as the price it will pay for non-contract livestock out of one of its plants next week. The Captive Supply Reform Act would end this price-manipulating practice by requiring contracts and agreements to have a fixed base price. It *would allow* contracts to be based on futures market prices, and it would not affect any premiums, discounts, or other adjustments now used in many forward contracts and marketing agreements.

S. 2021 would restore competition by making packers (and livestock producers) bid against each other to win a contract. Forward contracts and marketing agreements allow packers and producers to coordinate supply and reduce risk, but as they are currently negotiated – in secret, with all of the bargaining power on one side – they unjustly depress prices and reduce market access for small and independent producers. S. 2021 would require such contracts to be traded in open, public markets (such as an electronic market) to which all buyers and sellers could have access. The bill preserves the benefits of forward contracts and marketing agreements, while eliminating characteristics of current contracts that lead to price manipulation and price discrimination.

We urge this Committee, the United States Senate and the Congress to adopt Senator Enzi's Captive Supply Reform Act and Senator Johnson's proposed ban on packer ownership of cattle. We also encourage the Committee's stringent oversight of USDA's enforcement of the Packers and Stockyards Act, including section 202 and the provisions designed to protect poultry producers from unfair practices by poultry processors.

Attached for the record in this hearing are:

- WORC's petition for rulemaking as published in the *Federal Register*, Vol. 62, No. 9, Tuesday, January 14, 1997;
- Statement of Shane Kolb for the Western Organization of Resource Councils at the USDA Forum on Captive Supplies, Denver, Colorado, September 21, 2000;
- Section by section analysis of S. 2021, the Captive Supply Reform Act.

<sup>4</sup> Per January 2000 study by University of Missouri/National Pork Producers Council, cited in GIPSA report, *Assessment of the Cattle and Hog Industries, Calendar Year 2000*, p. 26)

**Statement of the Iowa Farm Bureau Federation  
On A Ban on Packer Ownership  
Submitted to the Senate Committee on Agriculture, Nutrition and  
Forestry  
July 16, 2002**

The Iowa Farm Bureau Federation is the state's largest general farm organization representing over 155,000 member families. Many of our members are primarily engaged in agricultural production including livestock production. The concentration in the agricultural sector, especially in the livestock sector, is an important issue for our members. We strongly supported Senator Harkin's efforts to include a ban on packer ownership of livestock as part of the 2002 farm bill.

Last year, delegates at the Iowa Farm Bureau annual meeting adopted a policy that prohibited packer ownership or control of livestock 14 days prior to slaughter. The American Farm Bureau Federation eventually adopted this policy, making it one of the few national farm organizations supporting a ban on packer ownership.

Increased concentration in agricultural markets has frustrated many livestock producers. Producers believe increased concentration has resulted in less market competition, less price transparency and lower prices. Many believe that the Packers and Stockyards Act has failed to prevent packers from squeezing independent producers out of the market.

The poultry industry is almost entirely vertically integrated, and the pork industry is becoming more so. At the packer level, the four largest firms' share of hog slaughter has reached 59 percent, compared with 40 percent in 1990. In 1997, 64 percent of all hogs were marketed through some form of forward sales arrangement between the

producers and packers, and approximately 10 percent of all market hogs involved entire or partial packer ownership.

According to USDA, those who produce at least 5,000 head annually currently account for nearly three-fourths of the hog production, compared with just over one-fourth in 1994. In the cattle sector, the four largest beef packers account for 81 percent of all steers and heifers slaughtered today, compared with 36 percent in 1980. The recent USDA captive supply report found that 25 percent of captive supplies in beef are packer owned. In the hog industry, the packer owned portion in some geographic markets is extremely high while the national market share is estimated at nearly one-fourth of the total slaughter.

The end result is a stark increase of packer market power by allowing packers to stay out of the cash market for extended periods of time, thus reducing farm gate demand and driving down prices. This can result in a severe reduction, or even elimination, of the ability of small and medium-sized producers to access the market. This can also result in an increase of packer market power by allowing packers to go to the cash market only during narrow "bid windows" or time periods each week rather than bidding all week.

Iowa has prohibited packer ownership of livestock since 1977. This past legislative session, the Iowa Legislature moved to clarify that packers cannot directly or indirectly own livestock. Despite opponents' claims to the contrary, contracting options for livestock producers are viable under Iowa's packer ownership prohibition. In fact, Iowa's law specifically allows for marketing contracts.

We strongly urge the committee to take steps to implement a ban on packer ownership. This action is necessary to ensure that small and medium-sized independent producers have improved market access.